

# Governance of Financial Sector Policies in the Post-Crisis Era

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## Abstract

This paper takes stock of current practices and provides recommendations on governance of financial sector policies—macroprudential policy (MaP), microprudential banking supervision (MBS) and bank resolution (BR)—, with a focus on mechanisms to ensure effective coordination across policies. A well-established institutional framework for each policy is a necessary, but not sufficient, precondition for effective coordination. The existing literature offers limited guidance in this regard. This paper builds on the findings from an extensive survey on governance practices for MaP, MBS and BR in European and Central Asian (ECA) countries and (high-income) benchmarking countries. The survey explicitly aims to disentangle means and ways of sharing information and analysis, communicating all through the decision-making processes, and resolving conflicts when they arise, both in normal and crisis times. The responses from the survey are used to guiding principles on the financial policy governance for ECA, but they could apply to many other emerging and developing countries.

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*Keywords:* Governance, Central Banking, Macroprudential Policy, Microprudential Supervision, Bank Resolution, Developing Countries

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# 1 Introduction

Global thinking and practice on financial policy governance started to evolve in the mid-90s. The pre-crisis discussion on governance issues focused mainly on whether the blurring of the traditional boundaries between banking, securities and insurance activities justified functional integration of supervisors. The objectives-based or “twin peaks” approach, where authorities for prudential and consumer protection regulation are separated, was part of this debate.<sup>1</sup> When considering the central bank’s (CB) role in microprudential banking supervision (MBS), it was usually argued that concentration of information helps to provide both the monetary policy and the supervision function.

Since the global financial crisis (GFC), there has been renewed interest in financial policy governance. This was brought by (i) the realization of the gaps in the existing governance practices with regards to information sharing and collaboration across financial policy actors, and (ii) the emergence of new policy areas—macroprudential policy (MaP) and bank resolution (BR)—and the resulting questions about organization, and in some cases integration, of them in the institutional frameworks.

Concerning the existing practices, there is a strong argument that one of the main reasons for (regulatory, supervisory and macroeconomic) policy failure leading up to the crisis was weak governance. Gaps in coordination and information-sharing mechanisms among different financial sector policies’ actors played an important role. Even where the microprudential supervisor was part of the CB, information to the areas of the CB responsible for monetary policy, financial stability, lender of last resort (LOLR) and the payment system did not always flow smoothly and promptly. There has also been concern that it may not be practically feasible to expect a single organization to fulfill multiple objectives requiring different skills, cultures, and approaches.<sup>2</sup> It became clear that, regardless of the architecture, countries must put in place arrangements that ensure active cooperation and coordination between the microprudential supervisor and the CB, especially in times of stress.

For the new policy areas, it is now recognized that MaP and BR need to be part of the financial sector policy framework. First, MaP has risen from the ashes of the GFC as a policy that aims (and has capacity) to prevent the build-up of excessive risks in the financial system as a whole. This has brought a host of new governance issues to the fore such as where this function should be placed, which instruments should be used and what type of relationships it may have with MBS, on the one hand; and with monetary policy, on the other. Second, the GFC also

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<sup>1</sup> Twin peaks structure proposed an institutional structure organized around two main objectives of financial sector policy—maintenance of financial stability and protection of consumers (Taylor, 1995). The essence of this proposal is that regulatory authorities are defined by types of objectives rather than by the institutions they regulate. The UK adopted a single integrated supervisory model in 1997, followed by some other European countries, as well as Japan and South Korea. Australia and Netherlands instead kept the prudential and conduct regulation separate.

<sup>2</sup> The evidence from the UK’s experience with a single supervisor generally suggests that the prudential and conduct regulation were practically incompatible as they required different skills and approaches (HM Treasury, 2010). Within this set-up, microprudential considerations were largely undermined as the conduct of business regulation received the most attention (FSA, 2009).

demonstrated that the regulatory toolkit of supervisors was not well equipped to deal with failing banks. Indeed, a central element of the international regulatory response (to increase banks' resilience) has been the development of resolution regimes, which would help initiate better organized, faster, and more cost-effective resolution. Many countries are now in the process of developing (or finalizing) their bank resolution frameworks, partly to overcome the political realities of bailing-out banks. A related governance question is who should initiate and oversee resolving failing banks, the prudential supervisor or another authority.

Most ongoing discussions about governance frameworks still suppose that (pre-existing) MBS and (post-crisis) MaP and BR can all be separated, and that objectives and tools used to promote one policy do not undermine the other. However, these functions can have different (and at times conflicting) policy objectives, their instruments can be cross-functional, and they could be implemented by multiple institutions in government. These interrelations among functions could be even more complex and challenging in crisis times when critical decisions encompassing all the financial stability functions must be made quickly.

In the post-crisis era, there is a need to formalize collaboration and coordination, which involves, at the minimum, sharing information and establishing processes for mutual interaction all the way up the decision-making level and conflict resolution. In this context, the institutional structure of financial sector policies—whether each policy is assigned to a separate authority or multiple policies are integrated in a single authority—and the incentives it embodies is critical. However, no institutional architecture can remove the need for cooperation, and a robust governance framework for each policy separately cannot guarantee efficient collaboration or coordination among policies. The different skill-sets, cultures, and perspectives of each policy may limit the exchange of information or the ability and willingness to internalize cross-impact of policies. As such, good and timely coordination remains very difficult to achieve in practice despite the evident need for and benefits of coordination.

As elsewhere, the need for having an appropriate governance framework which ensures the effective functioning of each policy, as well as their collaboration and coordination, is increasingly being recognized among Europe and Central Asia (ECA) countries. Such frameworks should at least provide clear mandates and tools for the institutions involved for MaP, MBS and BR; and explicit coordination and collaboration mechanisms during both normal and crisis times, including a solid legal basis for the exchange of information. While there has been a lot of effort in the region to develop sound financial sector policy frameworks, after the GFC, it is not yet clear how much progress has been made and where ECA stands relative to more developed counterparts.

Given this background, this study aims to document financial policy governance practices in ECA and benchmarking countries, and to highlight gaps and common practices in this regard. It is structured as follows. The second section motivates the study by giving an overview of the post-crisis thinking on the interactions among different financial sector policies. The third section describes the survey. The fourth, fifth, and sixth section discuss the survey findings in the area of overall institutional features; governance of MaP, MBS and BR; and cooperation and

coordination among them, respectively—in the context of the relevant issues and ongoing discussions. The seventh section identifies desirable elements of financial policy governance based on the survey results and gives policy recommendations on how countries can adjust their institutional structures to incorporate these principles. The final section provides conclusions.

## **2 Financial Policy Governance after the Global Financial Crisis**

The GFC has hit financial systems worldwide regardless of their governance models. Regulation and supervision failed to prevent the impact of the financial crisis in countries that adopted twin-peaks (Netherlands) or had a more diverse structure (the US) or an integrated supervisor (the UK). According to IMF (2010), the experience during the GFC did not indicate a clear superiority of any regulatory model. It also did not matter whether the CB was involved in supervision or not. Across the countries, Masciandaro, Pansini, and Quintyn (2011) show that none of the various frameworks of supervisory governance was superior to the others when it came to withstand the crisis.<sup>3</sup>

However, the GFC exposed the lack of adequate coordination and information sharing among policies overseeing different parts of the financial system in many countries. The example of the UK is well Bank of England, the Treasury and the FSA. The lack of reliable, smooth and effective inter-agency coordination and cooperation plagued the US system of financial regulation at the onset of the crisis (Omarova, 2014). Similar problems have also been identified in other countries (e.g. Netherlands and Spain). It also became clear that, irrespective of the architecture, countries must put in place arrangements to ensure effective information sharing and cooperation among different policies, most notably between the microprudential supervisor and the CB, especially in times of stress.

The GFC has also provided compelling evidence that challenges involved in the management of multiple policy objectives and in resolving conflicts between them in a single organization should not be underestimated. Bringing different policies under one roof does not eliminate the potential for conflicts between those policies but internalizes them. However, not all financial policy related functions are in close alignment and can be managed well within a single institution.<sup>4</sup> Avoiding such conflicts through separating agencies was indeed featured prominently in the thinking behind the development of the twin peaks model.

No specific institutional model can avoid conflicts of interest and inter/intra-agency conflicts and turf wars are likely to arise. For example, a supervisory model that assigns prudential

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<sup>3</sup> Earlier literature—such as Barth et al. (2002)—generally supports this view that supervisory architecture has no significant impact on financial outcomes. However, some recent studies find contrary evidence to this view. For example, Arnone and Gambini (2007) find that unified supervision and supervision by the CB are both positively associated with better supervision. Cihak and Podpiera (2007) find similar evidence on the positive impact of unified supervision on compliance. More recently, Dincer and Eichengreen (2012) argue that whether the supervisor is the CB and it is independent from government matter for outcomes.

<sup>4</sup> There are indications that in the run-up to the crisis, some supervisors were distracted by the conduct of business-part of their activities and neglected the prudential supervisory part (Schoenmaker and Veron, 2017).

responsibilities to the CB has the advantage of eliminating inter-agency fault lines in the flow of macro-micro information (and locating this information in an institution that needs to make LOLR judgment calls). Nonetheless, it also creates a risk of conflicts between macro and micro objectives, which may lead to insufficient focus on the microprudential supervision and raises the fears of creating a super-powered CB.<sup>5</sup> The current trend has indeed been for CBs to get more involved in microprudential supervision, sometimes under a twin peak model.

This paper takes a novel view that arrangements that organize the interaction among different policy functions are critical elements of a sound overarching financial policy governance. Regardless of the number of agencies, coordination arrangements should be formalized in a way that offsets the natural tendency of agencies to be territorial. These governance arrangements should try to avoid that information flows among policies on matters which interest all parties are sub-optimal. Moreover, for such arrangements to be effective, they should be supported by sound governing principles for the individual agencies such as having a clear mandate and objective, accountability and transparency arrangements. In addition to these principles, this paper takes a broader view and develops principles for an overarching financial policy governance framework. To our knowledge, this is the first paper that looks rigorously into the issue.

### **3 The Survey: ECA and Benchmarking Countries**

We conducted a comprehensive survey to identify issues and analyze practices on financial policy governance in January-September 2017 among 13 ECA countries (Albania, Armenia, Georgia, Kazakhstan, Kyrgyz Republic, Kosovo, Macedonia, Montenegro, Moldova, Poland, Russia, Serbia, and Ukraine) and in 8 high-income benchmarking countries (Australia, Austria, Czech Republic, Denmark, Hungary, Norway, Sweden, and UK).<sup>6</sup> We take the view that governance of financial policy governance is composed of three main building blocks (Table 1): (i) overall institutional aspects, (ii) governance of MaP, MBS, and BR, and (iii) coordination and cooperation among MaP, MBS, and BR in normal and crisis times. The survey questions can be accessed [here](#).

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<sup>5</sup> Similar arguments were used against the creation of a super-powered supervisor. In the UK context, McElwee and Tyrie (2000) argued that "...the FSA will be one of the most powerful, and one of the least accountable, institutions created in the UK since the War".

<sup>6</sup> We admit that the choice of benchmarking countries is a bit arbitrary. However, it reflects our preference to consider countries in Europe but outside of the Eurozone (that are under Single Supervisory Mechanism as the legislative and institutional framework), except for Austria given its ties between ECA countries. Australia is included as it has been pioneered several governance reforms (including the adaptation of the twin peaks model in 1997) and is generally considered to have a well-developed financial policy governance.

**TABLE 1. SURVEY FRAMEWORK**

<b>I. OVERALL INSTITUTIONAL FRAMEWORK</b>	<b>1. Key aspects</b>	<ul style="list-style-type: none"> <li>· Mandate</li> <li>· Role of the central bank</li> <li>· Degree of institutional integration</li> <li>· Role of the government</li> </ul>
<b>II. GOVERNANCE OF MaP, MBS, and BR</b>	<ol style="list-style-type: none"> <li>1. <b>Macroprudential Policy</b></li> <li>2. <b>Microprudential Banking Supervision</b></li> <li>3. <b>Bank Resolution</b></li> </ol>	<ul style="list-style-type: none"> <li>· Ownership of mandate and implementation</li> <li>· Decision-making</li> <li>· Transparency</li> <li>· Accountability and reporting requirements</li> <li>· Integrity</li> </ul>
<b>III. COORDINATION AND COOPERATION among MaP, MBS, BR</b>	<b>1. Coordination</b>	<ul style="list-style-type: none"> <li>· Coordination body/its functions</li> <li>· Information sharing</li> <li>· Collaborative analysis, discussion, and policy development</li> <li>· Consistent/coordinated policy decisions</li> </ul>
	<b>2. Oversight</b>	<ul style="list-style-type: none"> <li>· Checks and balances</li> <li>· Resolution of conflicts</li> </ul>
	<b>1. Control/Hierarchy</b>	<ul style="list-style-type: none"> <li>· Override powers</li> <li>· Ultimate source of authority</li> </ul>
	<b>4. Coordination in Crisis</b>	<ul style="list-style-type: none"> <li>· Crisis management mandate</li> <li>· Crisis committee/ its functions</li> <li>· Modes of information sharing in crisis</li> <li>· Ultimate source of authority in crisis</li> <li>· Cooperation challenges in crisis</li> </ul>

We prepared questions relating to each building block—(i)-(iii)—reflecting global thinking and achievable good practice on financial policy governance. We designed our questions in (i) mainly based on the institutional key elements identified in Nier et al. (2011) and FSB-IMF-BIS (2016). For (ii), we capture internationally agreed principles that characterize effective governance of each financial policy in the questions. This includes clarity of the mandate and the ownership implementation (operational independence); sufficient resources and enforcement powers and transparency, accountability and integrity are regarded as essential elements for effective governance structure for all MaP, MBS, and BR. Namely, we used FSB-IMF-BIS (2016) for MaP, the Basel Core Principles for Effective Banking Supervision (BCPs) for MBS, and Financial Stability Board’s (FSB) Key Attributes of Effective Resolution Regimes for Financial Institutions (KA) and the EU Bank Recovery and Resolution Directive (BRRD) for BR. While these resources involve some discussion on the interaction of MaP, MBS, and BR, they do not focus on how these interrelated policies work together effectively to achieve the overarching objective—stability and functioning of the financial sector. As such, to identify current consensus/debates on the ways these policies can collaborate and coordinate with each other in the last building block (iii), we use a broad range of resources, including OECD (2008), Nier

et al. (2011), Huang and Schoenmaker (2015), and several recent (publicly available) Financial Sector Assessment Program (FSAP)<sup>7</sup> reports.

Importantly, we contend that these questions provide a sound framework to analyze the governance of financial sector policies for all countries, regardless of specific institutional regime or the level of development in place. By taking a broader view on the quality and the design of the financial policy set-up to design questions, we move away from a narrow focus on the choice of specific institutional model towards guiding principles of good governance. Moreover, we focus on the elements of the set-up that should, in principle, apply to all countries across the board.

All institutions with MaP, MBS and BR functions in each country were involved in the survey, and in most cases, they sent one unified set of responses.<sup>8</sup> Each jurisdiction received a unique link to an online platform which, based on their answers, allows them to answer only relevant questions. For example, if there is no coordinating financial stability committee (CFSC)—a policy committee/council formed to coordinate the work of several decision-making bodies working on financial stability—, the respondents would skip questions regarding its governance. Also, while we keep the “spirit” of the questions the same across different institutional models, the specific questions on coordination among different functions change depending on whether these functions are the responsibility of the same or separate institutions.<sup>9</sup> Hence, the number of questions would change for each respondent, but it was around 100.

We believe that this work is of interest both in documenting legal foundations and practices on financial policy governance across countries, and as a diagnostic tool for policymakers to evaluate and improve their governance towards guiding principles. The survey provides a snapshot of policies in ECA and benchmarking countries and highlight common practices. Nevertheless, policymakers could use the survey results as a self-check to gauge, within a given country or across countries, how the different building blocks of the governance framework compare with one another and in which dimensions it falls short.

## **4 Overall Institutional Framework for Financial Sector Policies—Key Aspects**

In post-crisis era, major reforms to the financial policy governance have been implemented in a number of countries, alongside an even more general reconsideration of financial stability

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<sup>7</sup> The FSAP is a comprehensive and in-depth analysis of a country’s financial sector. FSAP assessments are the joint responsibility of the IMF and World Bank in developing economies and emerging markets and of the IMF alone in advanced economies. The FSAP includes two major components: a financial stability assessment and a financial development assessment.

<sup>8</sup> There were cases, however, institutions within a country sent their responses separately. In these cases, we cross-checked the answers and contacted the institutions again when there are conflicts.

<sup>9</sup> “Separate institution” for MaP, MBS, and BR and coordination function refers to the cases where there is a separate decision-making body (and in some cases different institutional and oversight mechanisms) than decision-making bodies of other policies (e.g. monetary policy). Such a separate body could be established under the roof of the CB/MoF/others or it could be a completely different institution.



policy itself. In the US, the Dodd-Frank Act in 2010 created of a centralized multi-agency MaP body, the Financial Services Oversight Council (FSOC), and expanded the Federal Deposit Insurance Corporation (FDIC)'s powers under the newly created "orderly liquidation authority" (OLA)—a specialized resolution regime for large financial institutions. Under the Act, the Federal Reserve is the authority responsible of MBS for all systemically important firms, with the power to adjust prudential standards for MaP reasons.

In the European Union (EU), a common view was forged around a proposal originally made by the de Larosière Group, which formed the basis for legislation adopted in 2010 by the European Parliament with respect to new governance arrangements in both the MBS and MaP spheres. The new European Systemic Risk Board (ESRB), with representatives primarily from central banks and supervisors, was given the responsibility for MaP within the EU. On BR, a new framework for dealing with failing banks, the BRRD was agreed in 2014, for national implementation as of January 2015.<sup>10</sup>

In the UK, 2012 Financial Services Act abolished the microprudential supervisor and placed the Bank of England (BoE) at the heart of financial sector supervision. Three new bodies was formed under the Act: the Financial Policy Committee (FPC), as a committee of the BoE responsible for MaP; the Prudential Regulatory Authority (PRA), as a legal subsidiary of the BoE responsible for the MBS; and the Financial Conduct Authority (FCA) as the independent conduct of business regulator.<sup>11</sup> Moreover, the legislation in 2009 which created a resolution regime, including powers for the BoE as resolution authority was further enhanced by legislation in 2014 implementing the BRRD. Many other (high-income and developing) countries also reformed (or are reforming) their institutional structures to refine and strengthen the existing MBS regimes, as well as to develop MaP and BR frameworks.

These institutional reforms have reflected the changes in global thinking of financial policy in response to the shortcomings revealed by the crisis. With the Group of Twenty (G20) providing political impetus, financial policy reforms—that have been agreed to include, among others, taking a greater account of macroprudential risks across the system and developing resolution frameworks for systemically important banks—were pushed to the forefront of the global stability agenda. These have mainly progressed through the FSB and its member standard-setting bodies, including the Basel Committee on Banking Supervision (BCBS). The credibility

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<sup>10</sup> The BRRD translates the FSB's KA in the EU context. KA, endorsed by the G20 in 2011, provide the new harmonized international standard for resolution regimes for financial institutions. Some European countries adopted the resolution mandate in their institutional design ahead of the BRRD. For example, in France, the Law on the Separation and Regulation of Banking Activities entrusted the ACP (Autorité de Contrôle Prudentiel) with the supervision of the preparation and implementation of measures in 2013 to prevent and resolve banking crises. The ACP thus became the ACPR—Autorité de Contrôle Prudentiel et de Résolution. The ACPR has several key committees, covering BR, MBS and MaP. The French system is indeed an interesting case in the sense that while the ACPR is financially independent and is by law defined as an independent administrative authority, its proximity with Bank de France is evident both in terms of leadership, logistics and staffing.

<sup>11</sup> The architecture was revamped in February 2017 with the creation of Prudential Regulation Committee, which replaced the PRA's Board.

of these reforms has been enhanced by expansions to the memberships of these bodies and the involvement of G20 Leaders.

While many of the reform proposals feature the introduction of explicit financial stability related mandates—in the context of this paper, for MaP, MBS and BR—, there is no consensus on which authority(ies) should have these mandates and in which manner. It is widely recognized that an effective financial stability framework is well-served by formally providing the relevant authority(ies) with clear mandates.<sup>12</sup> However, arguments can be advanced for a range of different institutional structures—particularly with regards to the role for the CB, the degree of institutional integration among different policies, and the involvement of government—, and it is perhaps not surprising that countries have come to differing conclusions depending in part on their own institutional background and their experiences during the crisis.<sup>13</sup>

#### **4.1 The Role of the Central Banks and Presence Formal Mandates**

CBs have always had some financial stability-related responsibilities, arising mainly from their unique position as the lender of last resort (LOLR), but they used to be broad and largely informal. As the monopoly issuers of money, CBs naturally have a control over the quantity of money and interest rates—monetary policy, and they are in charge of managing liquidity. Acting as the LOLR to private financial institutions at times of financial stress falls to CBs, and this has traditionally given them an essential role in crisis management. But their vital role in maintaining financial stability is also brought by the deep underlying connection with monetary stability—both are fundamentally about maintaining the public trust and confidence in money and financial markets. Indeed, CBs have been responsible for the smooth functioning of payment and banking systems in most (if not all) countries.

The evolution in global thinking and practice has led the proposition that CBs should have broader financial stability powers. There are obvious synergies between core central banking activities, and other aspects of what is now called financial policy. The position of CBs in financial markets is likely to give them early visibility of many types of financial stress. Formally entrusting the CB with other financial policy powers is said to enhance transmission of information between monetary policy and (macro-micro) supervisory and BR matters. One additional argument is that the human capital employed by central banks is presumably better equipped to manage financial stability issues. Having access to all information would help CBs, which possess higher skills, to act as more effective institutions in all the policy areas they are responsible for. And, to the extent conflicts occur between monetary policy and financial policy, they are most likely to be more easily resolved within a single institution. In other words, setting

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<sup>12</sup> The term “mandate” refers to a combination of the responsibility and authority to exercise state powers in pursuit of policy objectives. The existence of a policy mandate is most formal when law explicitly establishes the institution’s responsibility for executing the policy function(s), states the objective(s), and provides the powers and authorities that may be needed. However, formal extra-statutory devices—such as MoUs, exchanges of letters, formal statements of policy frameworks or policy strategies that are explicitly accepted by all relevant parties—may give the authority a suitably formal mandate.

<sup>13</sup> Edge and Liang (2018) provided a survey of formal macroprudential authority mandates.

up additional authorities different from the CB is not considered efficient, i.e. integration brings potential gains to all activities.

That said, there are also compelling reasons for the separation of financial policies from CBs. First, various policies need to be operationally independent in order to effectively fulfill their objectives. This points out, among other things, the need to have in place adequate structural arrangements to avoid conflicts of interest. Staff responsible for the various financial policy functions should be structurally separated and have separate reporting lines in the CB. Handling such diverse responsibilities and separate decision-making lines may prove challenging in practice, however. In particular, the CB's monetary policy responsibilities can negatively affect its behavior as an institution responsible for MaP, MBS and/or BR, and vice versa. For example, ability to conduct sound monetary policy may be in conflict at times with having a simultaneous responsibility for MaP and/or MBS. The CB may not want to initiate a (contractionary) monetary policy response if it is concerned about its impact on the health of supervised financial institutions.

Such conflicts seem rather overemphasized though as in most cases the micro and the macro concerns reflect and complement each other. At the same time, financial policy failures/misconduct can erode the CB's reputation, which adversely impact the credibility and, eventually, independence of the CB both in financial policy but also in monetary policy.<sup>14</sup> This suggests that there might be cases where keeping financial policies outside of the mandate of the CB is desirable to protect credibility and independence of the CB. This aspect of the argument is supported by the fact that financial policy is largely about prevention of undesirable events. It is difficult to set quantified targets for the success of such policy, therefore to achieve accountability and transparency. But failures would be obvious, and central bankers involved in financial policy can also produce greater policy failure risks. If the supervisor can discretionally manage liquidity, the risk of moral hazard (and therefore forbearance) can increase, as supervised banks know that their supervisor can save them. The central banker can use his/her powers in liquidity management to please its banking constituency, rather than pursue social welfare.

Most countries in ECA have overhauled their regulatory frameworks, generally to extend CB mandates to include explicit MaP and BR objectives, in addition to the pre-existing MBS objectives (Table 2).<sup>15</sup> Significant legislative changes were adopted in the post-crisis era to enhance the financial policy framework; and many countries in the region are currently pursuing additional legislative changes.

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<sup>14</sup> By mid-90s, both theory and evidence suggested that more independent CBs deliver better monetary policy outcomes, particularly lower and more stable inflation. Hence CBs in advanced and emerging economies rapidly converged upon the model of a CB that is independent from government. See sub-section IV.II.III. on the issues related to the involvement of government in financial policy governance.

<sup>15</sup> Section V covers whether the mandate for each policy function is clearly specified, i.e. explicit or implicit.

**TABLE 2. AUTHORITIES (WITH LEGAL BASE) FOR MAP, MBS, AND BR; AND THE ROLE OF GOVERNMENT**

	Macroprudential Policy	Microprudential Banking Supervision	Bank Resolution	Government given a financial stability related mandate?
<b>Albania</b>	Bank of Albania (L)	Bank of Albania (L)	Bank of Albania (L)	No
<b>Armenia</b>	Central Bank of Republic of Armenia (L)	Central Bank of Republic of Armenia (L)	Central Bank of Republic of Armenia 1/	No
<b>Georgia</b>	National Bank of Georgia (DoE)	National Bank of Georgia (L)	National Bank of Georgia 2/	No
<b>Kazakhstan</b>	National Bank of Kazakhstan (L)	National Bank of Kazakhstan (L)	National Bank of Kazakhstan (L)	Yes (MoU)
<b>Kyrgyz Republic</b>	NA 3/	National Bank of the Kyrgyz Republic (L)	National Bank of the Kyrgyz Republic (L)	Yes (DoE, MoU)
<b>Kosovo</b>	Central Bank of the Republic of Kosovo (L)	Central Bank of the Republic of Kosovo (L)	Central Bank of the Republic of Kosovo (L)	No
<b>Macedonia</b>	National Bank of the Republic of Macedonia 4/	National Bank of the Republic of Macedonia (L)	National Bank of the Republic of Macedonia (L)	Yes (MoU)
<b>Montenegro</b>	Central Bank of Montenegro 4/	Central Bank of Montenegro (L)	NA 5/	No
<b>Moldova</b>	National Committee for Financial Stability (DoE)	National Bank of Moldova (L)	National Bank of Moldova (L)	Yes (MoU)
<b>Poland</b>	Financial Stability Committee (L)	Polish Financial Supervision Authority (L)	Bank Guarantee Fund (L)	No
<b>Russia</b>	Central Bank of Russia (L)	Central Bank of Russia (L)	Central Bank of Russia (L)	Yes (L)
<b>Serbia</b>	National Bank of Serbia (L)	National Bank of Serbia (L)	National Bank of Serbia (L)	No
<b>Ukraine</b>	National Bank of Ukraine (L)	National Bank of Ukraine (L)	Deposit Guarantee Fund (L)	Yes (PD)
<b>Australia</b>	Australian Prudential Regulation Authority (L)	Australian Prudential Regulation Authority (L)	Australian Prudential Regulation Authority (L)	No
<b>Austria</b>	Financial Market Authority (L)	Financial Market Authority (L)	Financial Market Authority (L)	No
<b>Czech Republic</b>	Czech National Bank (L)	Czech National Bank (L)	Czech National Bank (L)	No
<b>Denmark</b>	Ministry for Business and Growth (L)	Danish Financial Supervisory Authority (L) 6/	Danish Financial Supervisory Authority Financial Stability Company (L)	Yes (L)
<b>Hungary</b>	Central Bank of Hungary(L)	Central Bank of Hungary (L)	Central Bank of Hungary (L)	No
<b>Norway</b>	Ministry of Finance (L)	Financial Supervisory Authority (L) 6/	Financial Supervisory Authority (L) 6/	Yes (L)
<b>Sweden</b>	Swedish Financial Supervisory Authority (L)	Swedish Financial Supervisory Authority (L)	Swedish National Debt Office (L)	Yes (L)
<b>UK</b>	Financial Policy Committee (L) 7/	Prudential Regulation Authority (L) 7/	Bank of England (L)	Yes (L)

L=Law

DoE=Decision of the Executive PD=Presidential

Decision MoU=Memorandum of Understanding

1/ Resolution regime is not yet defined. Assessment of current legal framework is ongoing.

2/ No explicit mandate is defined in a legal base.

3/ In Kyrgyz Republic macroprudential authority is not defined. Both National Bank of Kyrgyz Republic and the Ministry of Finance have MaP responsibilities.

4/ Macroprudential policy mandate is implied in the Central Bank Law.

5/ In Montenegro, bank resolution framework is being developed.

6/ Under the Ministry of Finance.

7/ Under the Bank of England.

In almost all ECA countries, the CB is the cornerstone of financial sector governance—all three policies (when they exist) are the responsibility of the CB by law. This is the result of a less complex and shallower financial structure and limited qualified staff in smaller countries or

countries with smaller financial systems.<sup>16</sup> The history has played its role as well—the region has been more prone to financial stress and bank failures, especially in the aftermath of an initial liberalization of the banking system. Even before the GFC, CBs were focused on financial sector issues and have long been microprudential supervisors. The connections between prudential policy and monetary policy, including LOLR operations, are therefore more frequent and evident in ECA than in developed countries. Moreover, the CB is typically the most credible agency with the highest governance standards—including satisfactory levels of expertise, independence and funding, making it the natural agency to perform these policies in ECA countries.<sup>17</sup> In some cases, MBS was brought (back) to the CB after the crisis (Georgia in 2009, Kazakhstan in 2011). The transfer of these responsibilities would need to be accompanied by strong governance and a transparent accountability framework that ensures checks and balances.

There is some variety in the institutional set up among policies in ECA. While all countries have a formal mandate on MBS enshrined in the law, this is not the case for MaP and BR. In the Kyrgyz Republic, the authority responsible of MaP is not defined; in Macedonia and Montenegro, the MaP mandate is implicit in the law; and in Moldova the mandate is adopted by a Decision of the Executive (DoE). In Armenia, Georgia and Montenegro, there is no formal BR mandate yet. The organization of MaP and BR is also more varied than MBS among countries. The CB is responsible from MBS in all cases (except for Poland). In Moldova and Poland, MaP mandate belongs to a committee; and in Poland and Ukraine, BR mandate belongs to the Deposit Insurance Agency (DIA).

In the benchmarking countries, the CB, microprudential banking supervisor and/or some parts of government have the responsibility for these functions. After the GFC, the UK and more recently Hungary went through fundamental reform of the institutional arrangements, which integrated MBS to the CB and appointed the CB as the resolution authority (RA). The UK established a decision-making body for MaP (Financial Policy Committee, “FPC”) and later for MBS (Prudential Regulation Committee, “PRC”). Hungary tasked a single committee (Financial Stability Board) with all three policies. In the Czech Republic, the CB is recognized as the primary authority responsible for financial policies. In some cases (Australia, Austria, Denmark, Norway, Sweden), there has long been a separate MBS authority, which now assumes responsibility for MaP and/or BR.<sup>18</sup> All the benchmarking countries provided legislated mandates for MaP, MBS and BR, regardless of the institutional structure.

## **4.2 The Degree of Integration among MaP, MBS, and BR**

There is no consensus on whether MaP, MBS and BR should be under a single roof. Authorities that are responsible for these policies would need to work closely together and with the CB, regardless of the institutional set up. If they are united under a single institution, however,

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<sup>16</sup> Moreover, some ECA countries use economic theory to get some legal interpretations for the role of the CB in MaP and BR. For example, some claim that the mandate for monetary stability includes financial stability, or the responsibility for the functioning of payment system implies the responsibility in the resolution of systemic banks.

<sup>17</sup> Some of these features apply to many other emerging and developing countries. See Goodhart (2000).

<sup>18</sup> In Austria, the CB also has MaP responsibilities.

operational and functional independence should be ensured by a structural separation of reporting and financing lines, and the staff involved in carrying out the respective policies.

Even with sound arrangements in place, institutional structure may still matter for the effectiveness of the financial policy framework in some cases.

- First, given budget constraints, creating various agencies can result in inefficient allocation (or misallocation) of scarce resources. For example, data collection, processing, and analysis for cross-policy purposes may be easier to consolidate if the policies are integrated. The flow of soft information (which is difficult to convey and easy to manipulate) may not be optimal with multiple agencies (Agur and Sharma, 2015).
- Second, institutional form can have some influence on the type of staff involved, their perspective and understanding of the issues, as well as their professional skills (Goodhart, 2000). For example, in a setting where the CB is the microprudential and macroprudential supervisor, the macroprudential objective may dominate as economists set the dominant culture (Goodhart et. al, 2002). Combined with resource constraints, this is an important concern for emerging and developing countries.
- Third, when policies are integrated, the manageability of an organization with such diverse responsibilities can be challenging; and senior executives of different departments/divisions can see each other as potential rivals for the positions at the top (Ferran, 2011). Moreover, in a single agency the function that receives the greatest emphasis may be that having the greatest political saliency—this implies that as long as the bank failures are rare, BR may not be the main focus of the agency (Taylor, 2011).<sup>19</sup>

In ECA, the institutional architecture is centered around the CB and this brings a high degree of integration among MaP, MBS and BR functions (Figure 1). To quantify this, an Herfindahl–Hirschman Index is calculated (as the sum of squares of the “power share” over the three functions) for both ECA and the benchmarking countries—on average, they show about 90% and 80% of integration among the policy functions, respectively. As mentioned before, the role played by CBs is much more prominent in ECA—in the benchmarking countries, when the functions are integrated into a single authority, only about 30% of them has the CB as the responsible authority (compared to 100% in ECA).

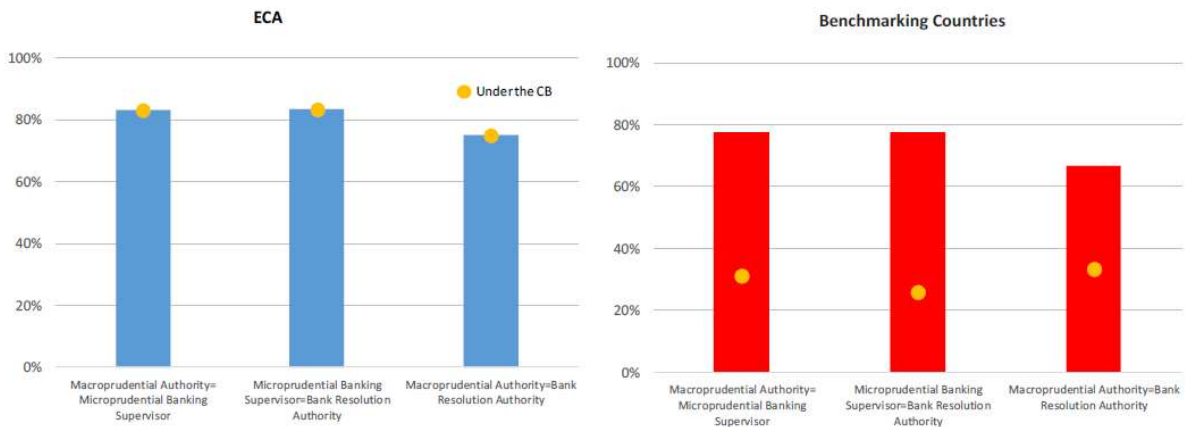
Both ECA and benchmarking countries have adopted various forms of institutional arrangements for the conduct of MaP, MBS and BR (Figure 2). In about 20 (30) percent of the ECA (benchmarking) cases, one or more of these policies are allocated to a separate authority. When at least two policies are integrated into one agency, it is more common in ECA to integrate them in one department. There are however important differences in the governance arrangements for MaP, MBS, and BR—in ECA, a single department (within a single institution) is often responsible for both MBS and BR, and operational and functional independence of BR

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<sup>19</sup> Tucker (2014) has argued that monetary policy is viewed as more important than MBS (and now MaP) and gets more public attention, so making the CB responsible for responsibilities other than monetary policy would shortchange the others.

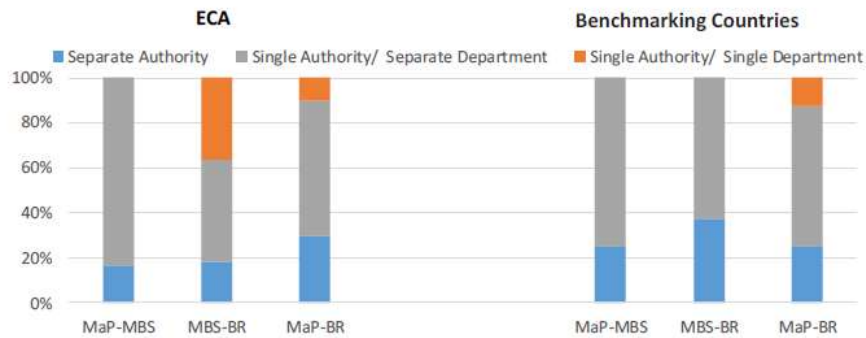
remains weak as it typically shares staff, financing and reporting lines with MBS.<sup>20</sup> In the benchmarking countries, MBS and BR are always handled by either separate authorities or—if they are within the same authority—separate departments; and, in the case of the latter, the structural separation among policies is overall clearer (but far from complete). However, separate authorities or structurally separate departments are usually responsible for MaP and MBS, supported by dedicated staff and reporting lines in both country groups. In about 10 percent of the benchmark countries, MaP and BR are integrated into a single department, often in the context of crisis management.

**FIGURE 1: THE DEGREE OF INTEGRATION AMONG POLICIES**



Prominent role for CBs in financial stability. The figure shows Herfindahl–Hirschman Index, calculated as the sum of squares of the “power share” over MaP, MBS, and BR. On average, both ECA and the benchmarking countries show high degree of integration, the integration always happens under the CB roof in the ECA (as indicated by the orange dot).

**FIGURE 2: INSTITUTIONAL FORMS FOR MAP, MBS, AND BR**



Multiple policy functions, particularly BR, are sometimes integrated in a single department in ECA. This is in sharp contrast with the practice in the benchmarking countries where MBS and BR are always handled by either separate authorities or separate departments.

<sup>20</sup> More detailed information on the structural separation of policies (separation of reporting and financing lines and the staff involved in carrying out tasks for each policy) is presented in Section V.

### 4.3 The Role for Government

While central banks and supervisors should be independent, some involvement of government in the financial policy framework is inevitable and may at times be desirable particularly in crisis times. Traditionally CBs were given operational independence because they conduct monetary policy. Yet, an independent institutional setting is essential for supervisors, macro and micro. Regulatory and supervisory independence is as important to financial stability for the same reasons that central bank independence is important for monetary stability. Financial stability is a public policy objective and politicians are ultimately responsible for a sound and stable financial sector, even if they delegate the task to an independent authority. Indeed, supervisors are granted a wide range of powers to regulate and supervise financial institutions, yet they need independence to withstand industry and political interference while performing their tasks. Bank supervisors that are not sufficiently independent are usually pressured to delay intervention for fear of taxpayer backlash. The resulting forbearance exacerbates the problems. For MaP and MBS, it is more difficult to achieve transparency and accountability than for monetary policy. Hence, accountability is essential<sup>21</sup> and supervisors and central banks need to demonstrate that they operate under good governance and in accordance with their mandate and objectives.

A government role remains to create political legitimacy, enable decision makers to consider policy choices in other fields (e.g. when cooperation of the fiscal authority is needed to mitigate systemic risks) or when changes in legislation are needed to expand the legal and regulatory toolkit. In the crisis management or resolution phase, the Ministry of Finance (MoF), or government more broadly, need to play a clear role, since measures could involve the use of central government budget (and hence taxpayer's money). In this context, some argue that if the CB oversees MaP, MBS and/ or BR, various degrees of independence can be afforded to different functions within a central bank.<sup>22</sup>

However, there should be safeguards against undue political influence that would compromise ability of authorities to carry out their mandate. Financial policy decisions can be politically unpopular and expert knowledge is important. A dominant role of the government risks delaying action as short- term political considerations could prevail over policy objectives.

Broader institutional set up also matters in deciding an appropriate role for the government in the financial policy structure. In countries where the rule of law is not strongly embedded in the political culture, there can be big gaps between the formal institutional arrangements and their practical impact. More generally, having some role for government may work well in countries where institutions are strong and stable, the political leadership is truly committed to financial stability, and anti-crisis constituencies are strong enough to keep policies on track. This is not

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<sup>21</sup> Nevertheless, high CB officials are commonly nominated by the government and, in many cases, confirmed by the legislative branch.

<sup>22</sup> Stanley Fischer, one of the intellectual forces behind modern central banking, stated in 2014, that: "...Some of my colleagues say, well, you can't be independent in one role and not in another. Well, I don't think any of them are married, if that's what they say. You can be. There are things you do (separately) and there are things you do together. I don't see why you can't be independent one way and not in the other..."



the case for countries where politicians depend on constituencies with a strong anti-regulatory bias, or where idiosyncratic factors and vested interests drive policies. Even at times of financial stress, a bigger role for the CB and/or other supervisory agencies may be desirable if there is a risk that the government falls into the trap of pretending to handle a crisis on their own as a public relations exercise or use it to win a political advantage.

In the survey, the involvement of government in a policy ranges from having a mandate/decision power to providing advice.<sup>23</sup> “Decision/co-decision” refers to the cases where the government is a decisionmaker or it can direct policies or rules to other agencies. “Recommendation” refers to the cases where the government can give recommendations to other authorities and its recommendations are hardened through a “comply or explain” obligation on the recipient of the recommendation. “Advice” refers the cases where the government can give recommendations to other authorities, but its recommendations are non-binding, and “coordination” refers to the cases where the government only provides a platform for joint analysis and peer pressure among other authorities.

Except for the Kyrgyz Republic and Moldova, the role of government in the financial policy framework is generally limited in ECA (Table 2). The government has a financial stability related mandate in less than half of ECA countries. In Macedonia, Russia, and Ukraine, the government can give advice or recommendation on MaP and crisis management through a council or committee structure. In Kazakhstan, the recommendation and advice powers of the government extend to MBS and BR. In the Kyrgyz Republic, while the MaP is not yet defined, both the CB and the MoF have some responsibilities related to system-wide stability of the financial sector. In Moldova, the government has the ultimate responsibility for MaP and MBS.

In the benchmarking countries, the role of the government is somewhat more pronounced, partly due to the heavy presence of Scandinavian countries in the sample. In Denmark, Norway and Sweden, the funding necessary following the banking crisis in early 1990s was provided by the government. It did so either directly to rescue the banks, or indirectly via institutions established to support the banking system, such as asset management companies. This consequently brought a regulatory structure where the government has final oversight in the operation of the regulatory system. As Goodhart and Schoenmaker (1995) put it: “He who pays the piper, calls the tune”—as the rescues are increasingly being financed by the tax-payer, so the responsibility for supervision and regulation of the system (to avoid excessive calls on such tax-payers’ money) passed more and more from CBs to separate agencies established under the aegis of the governments.

As new policy areas have emerged after the GFC, the dominant role for the government has been preserved. In Denmark and Norway, MaP is under direct responsibility of Minister of Development and Growth and Minister of Finance (MoF), respectively; and microprudential supervisor and RA are also under MoF in both cases. In Sweden, the overarching strategic

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<sup>23</sup> We use the same terminology when considering the involvement of any other authorities throughout the paper.

direction of the microprudential supervisor and MaP lies in the hands of the government. In addition to Scandinavian countries, the UK financial policy framework also has a clear role for government—for example, HM Treasury is required to give the macroprudential authority (Financial Policy Committee—FPC) written notice each year of the Government’s economic policy and must make recommendations about the Committee’s responsibility in relation to financial stability. Moreover, the BoE must consult with the microprudential supervisor (Prudential Regulatory Authority—PRA) as well as Treasury. The latter may decide to inject funds or put a firm into temporary public ownership. If there is potential risk to the public funds and there is a serious threat to financial stability, the Chancellor of the Exchequer can also direct policies to the BoE.

## **5 Governance Arrangements for Macroprudential Policy, Microprudential Banking Supervision, and Bank Resolution**

In this section, we document governance arrangements for MaP, MBS, and BR based on the survey responses. We consider four key elements across the three policies—(i) explicit mandate and accountability, (ii) structural separation of policies, (iii) decision-making body and its structure, and (iv) the role of government/other authorities. Where relevant, we also analyze several other elements relevant to a specific policy/ies.

A clear and explicit mandate for each policy—whether assigned to an existing/new authority or a new policymaking committee/inter-agency body—legitimizes policy action and provides the foundation for assigning responsibility for policy decisions. Moreover, since there are inherent complementarities and tensions among policies—and since the boundaries and interactions between them are complex—a clear mandate can help avoid such tensions or boundary disputes and ensure appropriate instrument use and policy mix. As such, a clear and explicit mandate not only helps manage policy tradeoffs, but also safeguards the autonomy of separate policies. By assigning responsibility and specifying the appropriate range and reach of powers, a clear and explicit mandate also fosters accountability.

A strong accountability regime in turn strengthens independence. While it may be well established that the authorities responsible of MaP, MBS, and BR should be afforded operational independence to pursue their own mandates, this should be within the context of public accountability. Accountability boils down to a system of “checks and balances” to ensure that the authority, though operationally independent, is acting appropriately when executing (each of) its functions. In addition to a well-defined objective, an accountability framework can include a range of communication tools and mechanisms to enhance transparency of the policies. This would help the public understand whether appropriate policy action is being taken and reinforce proper and effective conduct by the policymaker. Clear communications regarding the policy strategy and decisions taken (policy statements), regular reporting, publication of meeting records, and legal provisions for consultation requirements could be a part of the accountability framework. There might also be provisions in the legal base for legal action for enquiries, independent assessments, and oversight.

When MaP, MBS or BR are part the same authority, a structural separation should ensure operational independence of each policy. This implies that, at minimum, reporting and financing lines and the staff involved in carrying out tasks for each policy should be separate. For example, if the same authority is responsible for MaP and MBS, reporting lines (up to the highest possible level, i.e. Deputy Governor or a Board member) of the divisions responsible for the policies should be separated so that each policy receives full attention rather than one overshadowing the other. This would help the authority strike the right balance between the policies without being biased in favor of one (especially when the two policy objectives come to conflict). Similarly, if the same staff is responsible of multiple policies, one policy's objectives may also come to unduly dominate the other. For example, if the MBS and BR share the same staff under the microprudential supervisor, microprudential objectives are likely to be prioritized as the supervisors (rather than lawyers) set the dominant culture.

Effective decision-making processes for MaP, MBS and BR functions require a strong internal organization (including internal checks and balances) and a clear division of responsibilities. A (dedicated) committee structure can help aggregate a large volume of diverse information, including anecdotes and impressions, which can provide valuable insights. This typically ensures that various experts are involved in arriving at decisions, narrow focus is avoided, and decisions are easier to defend. Especially when the number of relevant agencies involved is large, decision-making through committee structures is generally believed to minimize inter-agency conflicts and facilitate implementation. In the committee, simple or qualified majority rules for voting on policy measures should be used, rather than unanimity which could make large committees unable to agree on a policy proposal under a time constraint. Regarding the policymaking body, it is well established that members should have long, fixed terms of appointments that are preferably staggered. This serves both to insulate members from political pressures as well as to ensure that members make decisions based on a long enough (medium term) time horizon, which in turn builds credibility and commitment.<sup>24</sup> This suggests that decision making processes for these functions would be served well by ensuring, preferably by law, that the term of members of the policymaking body are fixed or at least of a minimum duration.

Although some involvement of government to MaP, MBS, and BR might be useful to avoid the “democracy gap” and to facilitate legislative changes when needed, a strong role for government can pose risks. As indicated in Section IV. III., governments may have incentives to oppose taking MaP/ MBS decisions in good times—when they are often most needed—because of their political nature. Particularly in countries where checks and balances on government actions are weak, it is advisable to leave the financial policy responsibilities to the CB or some other agencies that have independence. At a minimum, the role of the MoF/government and other authorities involved in financial policies needs to be formally and clearly spelled out in ways that align their comparative expertise with their responsibility and respect their independence.

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<sup>24</sup> Although such detailed and clear prescriptions regarding the design of the MaP, MBS and BR authority are harder to come by (one exception is Masciandaro, Quintyn and Taylor, 2008), the same logic carries over from monetary policy (see, for example, Vandenbussche, 2006; Hammond, 2011; Dincer and Eichengreen, 2014).

## 5.1 Macprudential Policy

In the post-crisis era, macroprudential policy has become a fully-fledged supervisory activity. The neglect, or lack of understanding, of systemic risks in the financial system in the run-up to the GFC made it clear that it is crucial to monitor and assess the system-wide threats to financial stability arising from macroeconomic and systemic factors as well as financial innovation. This move has led to a formal separation of the supervisory activity into “macroprudential” and “microprudential”.

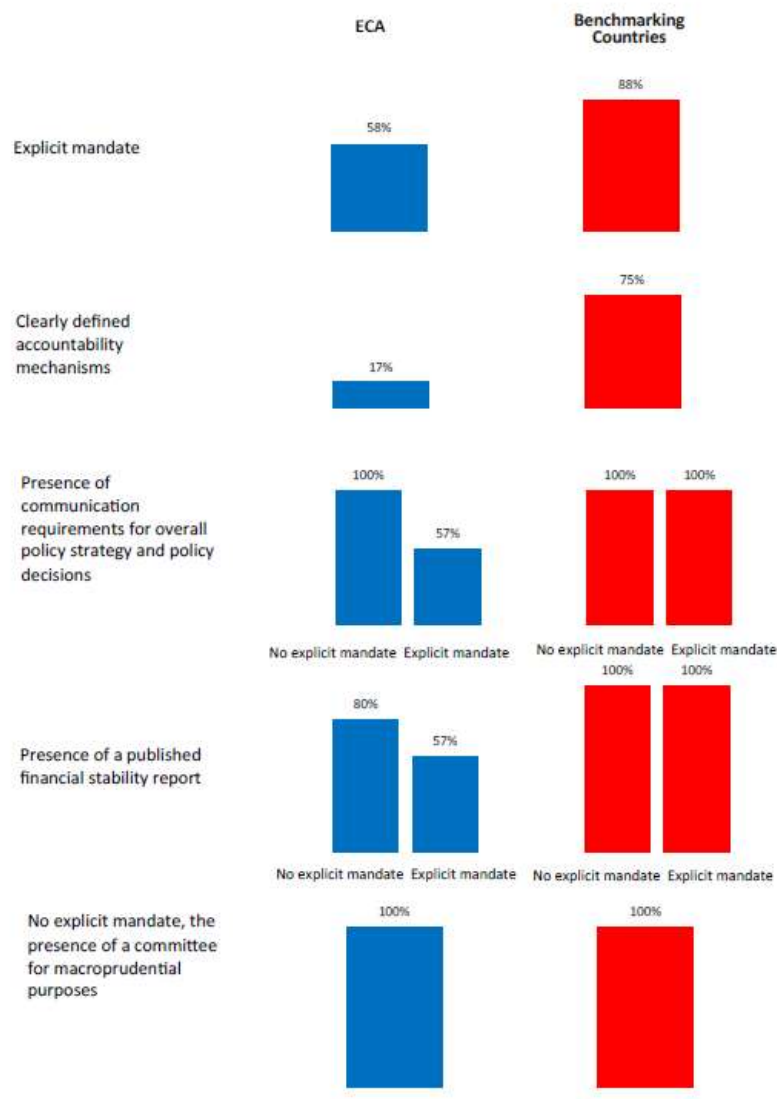
### 5.1.1. Explicit Mandate and Accountability

It is generally agreed that an explicit mandate, set in the law, is necessary to pursue an independent MaP related goals (BIS, 2011; IMF-FSB-BIS, 2016). While CBs inherently confront the issue of financial stability through their other functions, having an implicit “interest” in financial stability is not equivalent to having a related public policy mandate. Within the mandate, well-defined policy objectives further clarify the mandate and guide policymakers in the face of uncertain benefits and immediate costs towards both the “willingness to act” and the “ability to act” (IMF-FSB-BIS, 2016). Specifically, a clear and explicit mandate mitigates the tendency for defensive action by authorities in response to the fear of being held accountable for something that does not clearly fall under their responsibility. It also ensures hard decisions will be taken by the appropriate authorities if needed, and that such actions are defensible and (at least partly) insulated from ex-post challenges (BIS, 2011).

Accountability with respect to MaP is difficult to establish as there is no generally agreed quantification of financial stability, the transmission mechanisms of macroprudential instruments are not yet fully understood and distinction further needs to be made between normal times and times of crisis in the assessment of MaP (Goodhart, 2011). Still, at a minimum, there should be a requirement for publishing a periodic, written or oral report to the executive or legislative branch of government on the activities of the MaP authority, including an assessment of risks and policy actions taken to mitigate the risks.

In about half of the countries in ECA, MaP mandate remains implicit and accountability mechanisms are weak (Figure 3). About 40 percent of the countries in ECA do not have an explicit MaP mandate. This mainly reflects immediate needs in the post-crisis environment and the widespread hesitation to re-open the discussions on the CB laws (with the fears that this may jeopardize CBs hard-won independence with respect to monetary policy). Even more interestingly, however, this does not prevent countries in the region taking up MaP responsibilities—all ECA countries without an explicit MaP mandate have a committee/council for MaP, communicate policy strategy and policy decisions, and publish regular financial stability reports. In some other ECA countries with relatively recent CB laws, an explicit mandate for MaP is present, but they do not communicate policy strategy/decisions, or publish financial stability reports. In the benchmarking countries, there is generally an explicit mandate for MaP, supported by strong accountability and communication frameworks.

**FIGURE 3: SELECTED INSTITUTIONAL ELEMENTS FOR MAP**



While MaP mandate remains implicit and accountability mechanisms are weak in ECA, countries are taking up MaP responsibilities. Some other ECA countries with an explicit mandate for MaP do not communicate policy strategy/decisions or publish financial stability reports. In the benchmarking countries, an explicit mandate for MaP is common and generally supported by sound governance frameworks.

### 5.1.2. Structural Separation of MaP

In ECA, 35 percent of the countries do not have a dedicated department (within the competent authority) that focuses exclusively on MaP. Among the cases where there is a dedicated department, 30% of them do not have a dedicated reporting line. In the benchmarking countries, there is generally a dedicated department and a dedicated reporting line for MaP, structurally separate from other policy functions.

### 5.1.3. Decision-making Body and its Structure

It is generally suggested that a dedicated council/committee should be responsible for making MaP policy decisions and a (pre)set frequency of formal meetings should be established (IMF-FSB-BIS, 2016). This in turn facilitates communication regarding policy decisions and the management of private sector expectations. Where the board of the CB is the decision-maker, it further proves useful to have meetings dedicated to MaP issues.

Many countries have, or are considering introducing, a financial stability council/committee with a formal mandate for MaP. The mandate for the committee may include coordination and information exchange, monitoring and assessing systemic risks, discussing proposals and making recommendations for financial market issues, and supervising systemically important institutions (Nier et al., 2011). The existence of such a supervisory committee may promote coherence in the application of all policies regarding financial stability (FSB-IMF-BIS, 2011).

In the majority of ECA countries, the CB is the responsible authority for MaP and the Board or the Governor often makes decisions, generally without a pre-set schedule (Table 3). When the Board takes MaP decisions, the CFSC typically makes advice or recommendations. When the Governor takes the MaP decisions, there tends to be an internal advisory committee that advises or makes policy proposals. When a (separate) MaP committee takes the MaP decisions, however, it is set outside of the CB and the members of the committee generally do not have fixed/min term contracts. In the benchmarking countries, when the CB or the microprudential supervisor is the decision-maker, the decisions are taken always by a Board/Council (not by a single person such as the Governor or the Executive). Whether the MaP is under the CB or the microprudential supervisor seems to matter for the meeting schedule—in the former, policy meetings have a pre-set schedule, while in the latter, an ad-hoc schedule for decision-making is adopted.

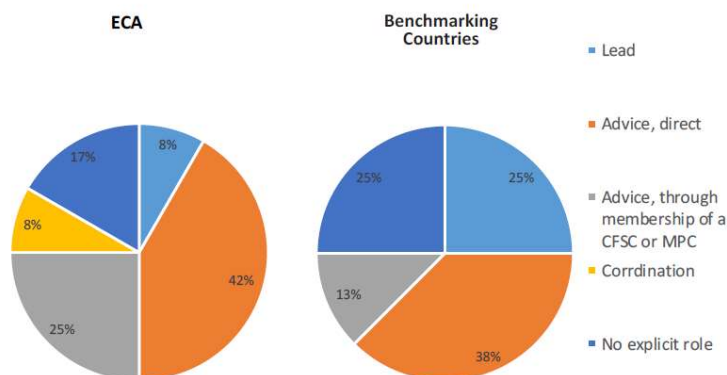
In ECA, government/MoF is involved in the formulation of the MaP as the decision-maker (lead institution) in only about 10 percent (Figure 4). However, it has advisory powers either through the CFSC (25%) or directly (42%). Among the benchmarking countries, 25% of them have government in charge of MaP (25%)—mainly reflecting the presence of Scandinavian countries in the sample—, and half of them have government as an advisor.

**TABLE 3: MAP DECISION-MAKING BODIES AND ADVISORY COMMITTEES**

	Macroprudential Decision-Maker	Who?	Pre-set Schedule for Decision-making	Fixed/min term requirements for all the members of the decision making body	Committee/Council with a Macroprudential Mandate	Powers	
ECA	Central Bank (10)	Board/Council (5)	Yes, quarterly (3)	Yes (4)	Yes (10) ...of which, separate from the CFSC (3)	Advice (4) Recommendation (6) Advice (1) Recommendations (2)	
		Governor (5)	Yes, quarterly (1)	Yes (4)	...of which, internal to the CB (4)	Advice (2) Recommendations (2)	
	Macroprudential Committee (2)	Committee (2)	Yes, quarterly (2)	Yes (0)	Yes (2) ...of which, separate from the CFSC (0) ...of which, internal to the CB (0)	Decision (2)	
		Board/Council (1)	Yes, quarterly (1)	Yes (1)	Yes (0)		
Benchmarking	Central Bank (3)		Yes, quarterly (1) Yes, bi-monthly (1)	Yes (1)	Yes (2) ...of which, separate from the CFSC (2) ...of which, internal to the CB (2)	Decision (2) Decision (2) Decision (2)	
		Microprudential Supervisor (3)	Board/Council (3)	No	Yes (2)	Yes (3) ...of which, separate from the CFSC (1) ...of which, internal to the CB (0)	Advice (2) Recommendation (1) Advice (1)
		Mof/Government (2)	Minister (2)	Yes, quarterly (2)	Yes (0)	Yes (1) ...of which, separate from the CFSC (1) ...of which, internal to the CB (0)	Recommendation (1) Recommendation (1)

Decision-making structures for MaP in ECA are not well developed. If the Board (of the CB) makes decisions, the CFSC typically makes advice or recommendations; and if the Governor is the decision-maker, there is often an internal advisory on an ad-hoc basis. If an outside committee formulates MaP, outside of the CB, fixed/min term requirements for the members of the committee are absent. In the benchmarking countries, the MaP decisions are taken always by a Board/Council, never by single decision-maker (the Governor or the Executive).

**FIGURE 4: THE ROLE OF MOF/TREASURY IN MAP**



Government/MoF is usually involved in MaP in ECA, mostly as an adviser. In the benchmarking countries, government/MoF has a bigger role in the decision-making reflecting the institutional arrangements in Scandinavian countries.

## 5.2 Microprudential Banking Supervision

The Basel Core Principles for Effective Banking Supervision (BCPs)<sup>25</sup> are the international standard for the supervision of banks. They are the benchmark for sound supervisory practices and are used by the IMF and the World Bank as part of the FSAP to assess the effectiveness of banking supervision. In the wake of the GFC, the BCPs were significantly revised in 2012 to reflect the main lessons and keep abreast of supervisory developments.<sup>26</sup> For this paper, the Core Principle (CP) 1 “Responsibilities, objectives and powers” and CP 2 “Independence, accountability, resourcing and legal protection” are of relevance.

### 5.2.1. Explicit Mandate and Accountability

Those CPs require prudential supervisors to have clear responsibilities and objectives and that those are well-defined in legislation and publicly disclosed. They also require the operational independence, accountability and governance of the supervisor be prescribed in legislation and publicly disclosed. The prudential supervisor should publish its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives.

A strong accountability regime provides legitimacy to the supervisor. Hence, clear communication of objectives and expectations to external stakeholders is essential for effective supervision. Typically, prudential supervisors frequently use annual reports, financial stability reports, business consultations, face-to-face interactions and circular letters sent to banks to communicate how they discharge their functions. While these forms of communication do not include institution specific matters or information that affects the privacy of individuals, it can cover overarching policy goals that are pursued for a group of institutions or for risk categories. Usually, publications include annual reports, disclosed policies and ad hoc reports and bulletins. Face to face exchanges can include formal appearances at parliamentary hearings, speeches, press conferences, special reviews and private meetings with legislators (BIS, 2015).

In the majority of ECA countries, the microprudential supervisor is housed in the CB, usually because of informational advantages and economies of scale in these smaller countries (or countries with smaller financial systems) by bringing all functions under the umbrella of one institution. The CB has a lender of last resort (LOLR) function and is responsible for the smooth functioning of payment and banking systems in most (if not all) countries. Having access to all information would help CBs, which usually possess excellent skills, to act as more effective supervisors. Finally, in many countries, the prudential supervisor also benefits from the

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<sup>25</sup> The European regulation, the Capital requirements Directive (CRD) and the Capital Requirements Regulation (CRR) do not address the governance of the MBS, unlike the BRRD, which sets requirements in for the resolution authority (see Section V.III.).

<sup>26</sup> For example, supervisory practices in risk management were significantly strengthened, supervisory intensity for systemically important banks was increased and system wide supervision as well as increased focus on early intervention and crisis management were included in the BCPs. Hence, the revised BCP has raised the bar significantly.



independence of the CB, which is often enshrined in law. As discussed in Section IV. I, however, there are also compelling reasons for the separation of MBS from the CB.

The survey shows that there appear to be written responsibilities and objectives, clearly defined in legislation and publicly disclosed, and accountability mechanisms and processes are generally also present (Figure 5). In all countries, the explicit mandate for MBS is enshrined in the law (with one exception in ECA). With regards to accountability, micro-prudential supervisors are often required to present written/oral reports to executive/legislative branches of government and are sometimes subject to ex-post assessments by independent commissions (set by the parliament/legislature). However, vague/multiple objectives (for example, consumer protection, efficiency and competition, promoting a financial center etc.) would make it more difficult to assess if the agency has achieved its goals. Moreover, more comprehensive and formal arrangements to disseminate information and to promote accountability are often missing in the region. About 35% of ECA countries communicate their overall strategy for the MBS and publish regular banking supervision reports (see also Figure 6). In the benchmarking countries, stronger accountability mechanisms are usually in place, along with communication requirements and practices.

### **5.2.2. Structural separation of MBS**

When the MBS function is integrated into the CB, it needs to be structurally separated to ensure operational independence for the supervisor. Generally, countries across the board have a separate department dedicated for MBS (where applicable) within the competent authority. Nevertheless, in about 40 percent of ECA countries, MBS shares the direct reporting lines with either MaP or with BR function. In the benchmarking countries, structural separation for MBS has generally been achieved.

### **5.2.3. Decision-making Body and its Structure**

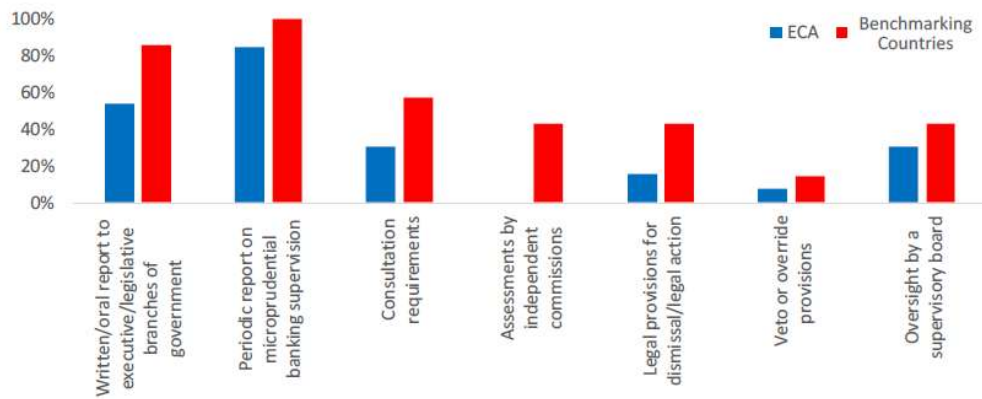
Prudential supervisors typically have a structured process in place for decision-making that includes internal checks and balances. In ECA countries, CBs are often responsible for MBS. If the Executive Board or the Governor takes the decisions, presence of an advisory committee that prepares policy proposals (that are then sent to the Board or Governor) is the norm (Table 4). A similar structure has been used in one case in ECA where Government (Ministry of Justice) is responsible for the MBS. Otherwise, in both ECA and the benchmarking countries, CBs delegate the decision-making for the MBS function to a designated Supervision Committee that meets regularly (and as needed). In the other benchmarking countries, it is also common to have a separate microprudential supervisor where decisions are taken at the Board level. In these cases, typically no additional (advisory or otherwise) committee structures are adopted, the Board meetings are organized when needed and fixed/min term requirements for the members of the Board are limited.

**FIGURE 5: SELECTED INSTITUTIONAL ELEMENTS FOR MBS**



While the MBS mandate is generally explicit in ECA, comprehensive arrangements to disseminate information and to promote accountability are often missing. In the benchmarking countries, stronger accountability mechanisms are usually in place, along with communication requirements and practices.

**FIGURE 6: MAIN ACCOUNTABILITY ARRANGEMENTS FOR MBS**



Transparency and accountability of MBS in ECA is limited. ECA countries communicate their overall strategy for MBS much less than the benchmarking countries, and publishing regular banking supervision reports is less common.

## 5.2.4. Role of Government/Other Authorities

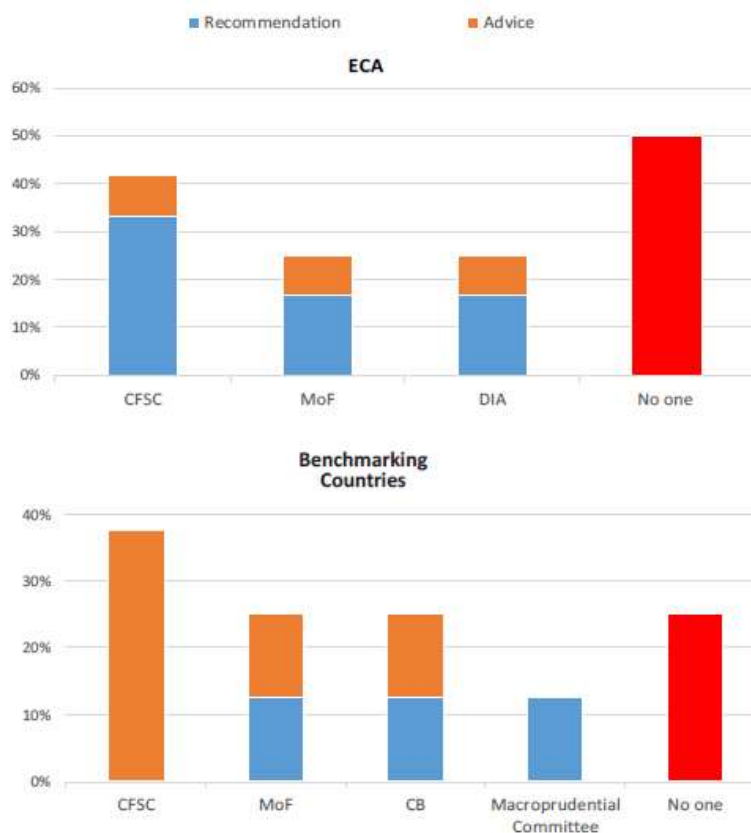
No other authority can give advice or recommendation (with comply or explain) to the microprudential supervisor in half of ECA countries (Figure 7). However, in many countries, the CFSC; and in some cases, the MoF and Deposit Insurance Agency (sometimes in addition to the CFSC) have advice or recommendation powers. In the benchmarking countries, the CFSC powers are limited to giving advice to the microprudential supervisor, and more generally other authorities play a smaller role in MBS decision-making process.

**TABLE 4: MBS DECISION-MAKING BODIES AND ADVISORY COMMITTEES**

Microprudential Decision-Maker	Who?	Pre-set Schedule for the members of the Decision-making	Fixed/min term requirements for all the members of the decision making body	Committee/Council with a mandate to form MBS policy decision/advice/recommendation	Powers of the Committee	
Central Bank (9)	Supervision Committee (3)	Yes(1)	Yes(0)	Yes(3)	Decision (3)	
	Board/Council (4)	Yes (3)	Yes (4)	Yes(4)	Advice (4)	
	Governor (2)	Yes (0)	Yes (2)	...of which, internal to the CB(4)		
ECA	Microprudential Supervisor (1) Board/Council (1)	Yes (1)	Yes (1)	Yes(0)		
	Ministry(1)	Ministry (1)	Yes (0)	Yes(0)	Yes(1) ...of which, internal to the CB(1)	Advice (1)
Benchmarking	Supervision					
	Central Bank (3)	Committee (2)	Yes(2)	Yes (1)	Yes (2)	Decision (2)
		Board/Council (1)	Yes (1)	Yes(1)	Yes (0)	
Microprudential Supervisor (5)	Board/Council (5)	Yes(0)	Yes(3)	Yes (0)		

There is often a structured process for MBS decision-making in ECA. If the Executive Board or the Governor takes the decisions, an advisory committee usually prepares policy proposals. Otherwise, in both ECA and the benchmarking countries, CBs delegate the decision-making for the MBS function to a designated Supervision Committee that meets

**FIGURE 7: AUTHORITIES THAT CAN GIVE ADVICE/RECOMMENDATION TO THE MBS AUTHORITY**



In many ECA countries, the CFSC; and in some cases, the MoF and DIA (sometimes in addition to the CFSC) have advice or recommendation powers for MBS. In the benchmarking countries, the CFSC only has advice powers, and other authorities play a smaller role in MBS decision-making process.

### 5.3 Bank Resolution

In the wake of the GFC, the FSB released the KA, the international standard for effective resolution regimes. The KA specifies essential features that should be part of the resolution framework at both the national and international levels. The objective of resolution regimes is to ensure authorities have the powers and tools to address failing banks without interruption to critical functions and without exposing taxpayers to loss. The KA include a comprehensive “toolkit” of resolution powers for national authorities, including powers to: (i) assume control of a financial institution from existing managers and owners; (ii) effect a resolution of the troubled institution through the sale or merger of the entity, the transfer of assets and liabilities of the institution to third parties, or through unilateral debt restructuring or “bail-in”; and (iii)

support the resolution through a temporary stay on the execution of early termination rights under financial contracts.

Since the GFC, the resolution authority (RA) has received a more prominent, and a more explicit role in the financial sector governance. Before the crisis, BR responsibilities were typically part of the microprudential supervisor, or more rarely the MoF. In some cases, when a systemic crisis hit a country, a resolution agency was established in an ad-hoc fashion. The size, speed and depth of the financial crisis, however, made it clear that BR responsibilities should be given more attention. It was felt that, as part of the governance of the financial system, there should be a dedicated agency that has the institutional memory and the knowhow to implement large scale resolution operations as and when needed, and that is less intertwined with banking supervision proper. Indeed, BR, particularly when a large and critical part of the banking system is in crisis, requires prompt and decisive action. Since such events only happen rarely, having the institutional memory and the knowhow to intervene is crucial. And this is best built up and preserved in a dedicated agency. The KA 2—“Resolution authority”— requires countries to have a designated authority(ies) responsible for bank resolution. It is also required that the RA has the operational independence consistent with its statutory responsibilities, transparent processes, sound governance, adequate resources and accountability.

### **5.3.1. Explicit Mandate and Accountability**

In Europe, the BRRD strongly supports the establishment of a separate agency with an explicit mandate for BR.<sup>27</sup> It is considered that a separate agency is the best way to guarantee independence, to minimize conflicts of interest, and to avoid time-inconsistency issues. As a separate agency, the resolution authority should have operational and financial independence. Its mandate and role should be clearly defined in the law. The law should describe the powers and the resolution tools of the agency, while at the same time guaranteeing a fair degree of flexibility to deal with each individual case.<sup>28</sup>

The BRRD also states that the agency should also have clear lines of accountability. Ideally, it should be accountable to the national parliament, through participation in hearings and the publication of an annual report. The operations of the agency should also be transparent (in part guaranteed through its accountability), while at the same time ensuring confidentiality in its operations. Accountability arrangements should help in clarifying situations where the RA faces potential conflicts and trade-offs when exercising resolution powers or applying specific

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<sup>27</sup> See also Chapter 5 of “Understanding Bank Recovery and Resolution in the EU: A Guidebook to the BRRD” by the World Bank.

<sup>28</sup> Despite the BRRD recommendation for establishing a separate resolution agency, several EU countries have opted for housing the BR within another existing agency. In many countries, the BR is set inside the microprudential supervisor, often for staffing reasons. At the level of the EU, the Single Resolution Board (SRB) has been established as a separate agency. On the other hand, in a small number of countries (for example, Spain and Denmark), the BR has been split between two agencies one in charge of “preventive nature” type of resolution, and one responsible for the “executive phase.”

resolution tools. The overarching aim of the RA should be to minimize the cost of resolution and avoid destruction of value, unless necessary to avoid the resolution objectives.

There should also be structural arrangements that ensure a clear allocation of responsibilities and ownership structures during the resolution process. As a rule, a financing arrangement is established through a resolution fund (industry-funded institutional backstop mechanism) and the RA is entitled to trigger its use, but the fund should be operated at arm's length. For example, the resolution fund could be placed outside the RA and given separate legal personality. In cases where the CB is the RA, the CB should not finance the resolution fund via the CB's own risk. That also applies to a "bridge bank" or an asset management vehicle (AMV)—if the RA partially owns shares in the bridge bank, day-to-day management should be the responsibility of the board of directors with only the limited involvement of shareholders or a separate public legal entity could be designated as the shareholder.

BR policy is generally housed at the CB in ECA (except for Ukraine and Poland), with an explicit mandate in about 70% of the cases (Figure 8). In most of these cases, the explicit legal mandate in BR was introduced in the last few years. Several other countries in the region, however, try to infer resolution-related mandates from responsibilities of CBs regarding financial supervision and/or the overall stability of the financial system. More broadly, the process of establishing BR framework and getting it aligned with the EU's BRRD, along with an assessment of the existing legal frameworks, is still ongoing in ECA, particularly in EU candidates. In the benchmarking countries, the BR is commonly housed at the microprudential supervisor, especially when it resides outside of the CB (except for Sweden). The BR mandate is explicit in about 75 percent of the cases, reflecting post-crisis changes in the respective laws.

Given that resolution regimes are still maturing in ECA, accountability mechanisms remain weak (Figure 8). In about 35 percent of the cases in the region, the authorities responsible for BR are required to provide oral or written reports to the executive/legislative branches of government, and the BR strategy is generally not communicated. In the benchmarking countries, RAs in 65 percent of the cases are required to report to the government—sometimes also participate in public hearings—and publish an overall resolution strategy.

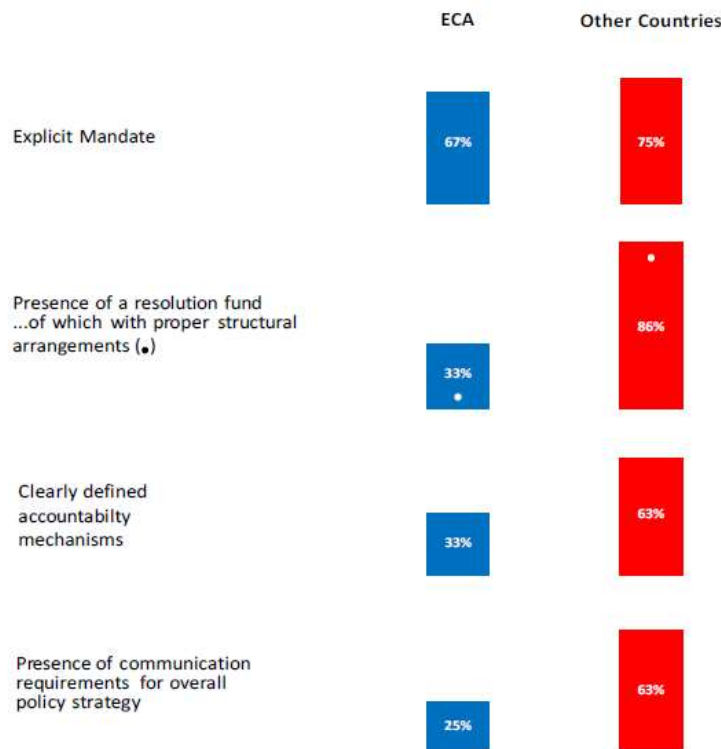
Institutional arrangements (in the ownership, the administration, and responsibilities) for resolution tools and steps, including the resolution fund (RF), are also limited in the region. For example, in the majority of ECA cases, the same body licenses, supervises, manages, and owns a bridge bank (or an AMV or RF).<sup>29</sup> In about 30 percent of the cases, a separate public legal entity, MoF or the CFSC, was designated as the shareholder or the RF is placed outside the RA to avoid the conflict of interest. Nevertheless, there are also some cases where the CB is the RA, and a multiple number of other authorities are empowered to have ownership and responsibility for the same resolution tool. In ECA countries where MBS and BR functions are handled by separate authorities, ownership of most of the tools resides with the RA. In the

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<sup>29</sup> About 30 percent of ECA countries have a RF in the existing frameworks.

benchmarking countries, financing of resolution through a resolution fund is common; and generally proper institutional arrangements are in place. Regardless of the MBS and BR integration into a single authority, there are often explicit mechanisms to limit conflict of interest while ensuring that the RA has powers over the tools. For example, in the case of a bridge bank, MoF and the CB (if the microprudential supervisor owns the tool) or the RF are also shareholders in most of countries; or it is formalized that a bridge bank would be established as a subsidiary of the RA.

**FIGURE 8: SELECTED GOVERNANCE ELEMENTS OF BANK RESOLUTION FUNCTION**



Governance arrangements for BR are still developing in ECA. Some countries in the region do not have explicit mandate for BR in the law, and accountability and reporting requirements are generally limited. In the benchmarking countries, RAs often are required to report to the government and communicate an overall resolution strategy publicly.

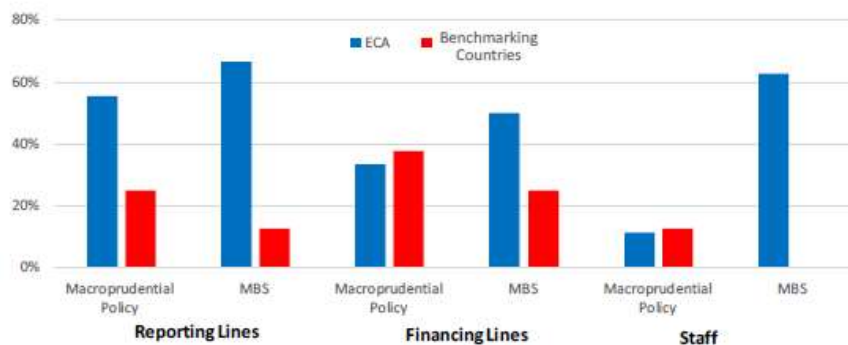
### 5.3.2. Structural separation of BR

In cases where the BR is housed inside the microprudential supervisor (which is sometimes part of the CB), structural separation of supervisory and resolution operations should be ensured. It is necessary to ensure separation as the supervisory regime usually assumes going concern and the resolution regime adopts a gone concern perspective. A separate board or a separate board member, e.g. the Deputy Governor or a Director, should be ultimately responsible for taking resolution decisions. Conflict of interest could arise more easily if the BR is embedded in an agency that has also other objectives. This could lead to time inconsistent solutions such as

searching for fiscally beneficial solutions or delaying intervention and resolution decisions. Separate financing lines are also needed to preserve the independence of the RA. If no private sector solution can be reached, the cost of recapitalizing an ailing bank will have to be borne by the government, not by the RA. This can be vague in cases where the RA is part of a ministry. However, if the RA is part of the CB, clear separation needs to be made between its operations and the CB's operations. Liquidity support to a troubled bank by the CB is the latter's responsibility. More generally, the CB should not finance resolution tools.

Structural separation of BR from other policies is generally not achieved in ECA (Figure 9). In majority of countries, BR shares reporting and financing lines as well as the staff with the MBS. It is also common to share reporting and financing lines with MaP, although the staff involved in carrying out BR and MaP are usually structurally separated. In the benchmarking countries, operational independence and separate reporting lines between BR and MBS (and MaP) are generally ensured when CB or microprudential supervisor is responsible for BR.

**FIGURE 9: STRUCTURAL SEPARATION OF BR FROM MBS AND MAP**



BR is often not structurally separated from MaP and MBS in ECA. BR shares reporting and financing lines with MBS or MaP. In the benchmarking countries, operational independence and separate reporting lines between BR and MBS (and MaP) are generally ensured.

### 5.3.3. Decision-making Body and its Structure

In ECA, there is usually not a designated decision-making body for BR (Table 5). The executive board (of the CBs) commonly takes the decisions related to BR, sometimes with advice from the CFSC. When there is a separate resolution authority (which in ECA also acts as a deposit insurance agency—DIA), it takes advice from the CB (and, if present, the CFSC) on the resolution decisions. In the benchmarking countries, CBs often delegate the decision-making for the BR function to a designated Resolution Committee (under the CB). In these cases, the committee members are typically not subject to the fixed-term requirements, and the MoF play a bigger role in the decision-making through advice, and sometimes recommendation and decision, powers. If the microprudential supervisor or a separate RA oversees the BR function, the CB can give advice either directly or through the CFSC.



**TABLE 5: BR DECISION-MAKING BODIES AND ADVISORY COMMITTEES**

	Bank Resolution Decision-Maker	Who?	Fixed/min term requirements for all the members of the decision making body	Authorities with advice/recommendations on issues related to bank resolution
ECA	Central Bank (10)	Board/Council (8)	Yes (5)	CFSC(4)
		Governor (2)	Yes (2)	MoF (1) DIA (1)
	Resolution Authority (2)			
	...which also provides Deposit Insurance (2)	Board/Council (2)	Yes (1)	CB(2) CFSC(1) MoF(1) MBS(1)
Benchmarking Countries	Central Bank (3)	Resolution/Other Committee (2)	Yes (0)	MoF (2)
		Board/Council (1)	Yes (1)	DIA (1)
	Microprudential Supervisor (2)	Board/Council (2)	Yes(1)	CFSC (2) CB(1) MoF(1)
	Resolution Authority (2)			
	...which also provides Deposit Insurance (1)	Board Board/Council (2)	Yes(0)	CB(2) MBS(1) DIA (1) MoF(1)
	Ministry of Finance (1)	Ministry (1)	Yes(0)	CB(1) MBS(1) DIA (1)

There is usually not a designated decision-making body for BR in ECA. The executive board (of the CBs) commonly takes the decisions related to BR, sometimes with advice from the CFSC. When there is a separate RA, it takes advice from the CB (and the CFSC). In the benchmarking countries, CBs often delegate the decision-making for BR to a Resolution Committee and the MoF can give advice or recommendation, and sometimes can make decisions.

### 5.3.4. Role of Government/Other Authorities

The role played by other institutions in BR vary depending on the existing institutional arrangements. In ECA, when the CB is responsible for resolution (which is the majority), no other authority takes a part in the resolution processes in about 30 percent of the cases, perhaps reflecting the fact that CBs in this case typically are mandated for both MaP and MBS functions as well. The MoF (and sometimes also the CFSC) decides the use of public money for resolution purposes, and the DIA decides on the use of deposit insurance money in about half of the cases. When there is a separate RA, preparation and early intervention powers as well as the decision to take resolution action belong to either the CB or the microprudential supervisor; and in all cases the use of public funds is decided by the MoF. In the benchmarking countries, when the microprudential supervisor has the responsibility for the BR function, roles and powers in the resolution process appear to be more dispersed among the agents—the CB usually plays a bigger role in preparation and early intervention, decision to take a resolution action, the use of public money, and does the impact assessment while the MoF also take a part in the adaptation of a resolution plan and in deciding the resolution action.

## **6 Governance Arrangements Coordination and Cooperation among MaP, MBS, and BR**

Financial policy inevitably involves multiple authorities. Inter-agency relationships and cooperation are crucial to effective action, especially during crises. For example, if MaP responses are decided and implemented by a different authority than the banking supervisor, close coordination is required to avoid operating at cross-purposes.<sup>30</sup> Even in cases where policies are integrated in the same agency, the same need applies, especially if the two functions are using separate reporting lines. As explained above, there is also the need to work closely with the government (and/or the CB if the financial policies are under a separate authority). Overall, mechanisms to foster cooperation and dialogue among all relevant authorities (including within the same organization and across staff) are a critical part of the financial policy governance to achieve synergies and the common goal of financial stability.

Several formal and informal governance arrangements can be used to achieve sound cooperation and coordination among MaP, MBS, and BR policies; and to ensure that conflicts are resolved efficiently and ideally in a constructive manner. These could involve, for example, setting up a CFSC where relevant authorities/departments are represented, or having a clear legal basis for information/ data sharing and interaction at the decision-making level. Defining ex-ante conflict resolution mechanisms can help prevent or resolve disagreements, particularly when policies are integrated in a single authority. Informal arrangements such as advisory committees and working groups can also enhance coordination. Explicit arrangements for coordination among policies during crisis, such as specifying which authority can trigger crisis powers or takes the lead in the face of crisis, can improve crisis preparedness process and help ensure decision-making process in a crisis works fast and smoothly.

### **6.1 Coordinating Financial Stability Committees (CFSCs)**

One way of coordinating policy advice and action is through a committee structure. Such structure can bring together all the stakeholders—the CB, the microprudential banking supervisor, the RA, and the government, along with other regulators. A CFSC can serve as the primary venue for apprising all the relevant agencies about matters of mutual interest, including but not limited to current risks to financial stability. It can be a forum for discussing decisions in one authority’s remit that might impinge on the mandate of another. As government is typically involved, a CFSC can also provide a platform to discuss issues that go beyond any individual authority’s mandate—this is especially useful if the regulatory perimeter needs to be adjusted through legislation. Regular exchanges among officials with different skills, perspectives, and objectives can help avoid “group-think” and improve the policy outcomes.

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<sup>30</sup> For example, leaning against a credit boom can be achieved either with an industry-wide capital buffer or binding supervisory directions to desist from certain practices. An authority responsible of MaP can be under the impression that the many small actions of the microprudential supervisor have pre-empted its decision. On the other hand, if the decisions of the MaP authority are not credible to the microprudential supervisor, it could use its prudential tools to offset them.

CFSC's may also help authorities to access to information that they may not normally have access to, including soft information. Moreover, it can also minimize interagency conflicts and facilitate implementation. For example, microprudential banking supervisors are less likely to resist enforcement of a MaP decision if they have had the opportunity to debate it. Finally, in times of crises, the committee can enforce the coordination of actions among members, in order to allow for a timely and efficient policy response.

### **6.1.1. Legal Basis for the CFSC and Its Functions**

A CFSC needs to be supported by a set of clear rules to be effective. These include a multilateral (and/or bilateral) agreement, such as an MoU, across all agencies. An MoU, however, does not change the power or instruments available to the individual authorities in any way, but it does clarify responsibilities and enable authorities to know and to practice in advance how they communicate with each other. If the Committee has more than an advisory role (for example, if it can direct policies to some of the authorities involved), this should be clarified in the legislation. More broadly, such agreements should explicitly describe the powers of the Committee and the modalities of the decision-making or recommendations. The roles and obligations of each authority, the authority/ies in charge of chairmanship and secretariat function, and the schedule for the regular meetings should also be clarified in the formal agreements. If the Committee has crisis management responsibilities, the agreement should clearly indicate if, and how, the elements of the agreement would change in times of crisis.

The role of a CFSC chair will be different for CFSC's that are platforms for information exchange and policy coordination and those that are bodies for decision making. The former committees may not have any hierarchy and no member can give orders to another. In this case, given the expertise in the area of macroeconomic and financial stability (and independence), the CB may naturally play a more proactive role with the governor as the chair, the CB as the secretariat of the Committee. If there is a separate microprudential supervisor, it can also house the committee. If the committee has decision-making power, however, it may be more desirable that the authorities in charge of these areas chair the committee. For example, if it has crisis management responsibilities, it would need to engage extensively in intergovernmental agency coordination (and crisis management could involve the use of taxpayers' money), the chairmanship role can belong to the MoF.

Even though CBs in ECA are generally responsible for all the policy functions, all countries have a CFSC (Table 6). The presence of these committees in the region may be explained by the need to reconcile the central role for the CBs in financial sector policies with some role for government, particularly during a crisis (see below for crisis-related powers of CFSCs). In fact, the CFSC is mostly set outside of the CB in ECA. Moreover, while the CB generally provides the secretariat function, it chairs the committee only in about 1/3 of the cases (Table 7). In the other ECA countries, either MoF or some other part of government chairs the Committee.<sup>31</sup>

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<sup>31</sup> The committee chairmanship can also rotate between the CB and the MoF, or the MoF can assume the chairmanship during crisis times. See Table 7.

Partly reflecting this interagency institutional structure, MoUs are most commonly used when setting up CFSCs. In the benchmarking countries where the CB is responsible for the MBS, CFSC structures are not used. And when the CB has no or limited MBS responsibilities, the CFSCs are set outside the CBs by a MoU. In these cases, the MoF/another part of government usually chairs the committee and provides secretariat functions.

**TABLE 6: PRESENCE OF A COORDINATING FINANCIAL STABILITY COMMITTEE AND ITS LEGAL BASE**

ECA				Benchmarking Countries	
Albania	Yes (L MoU)	Moldova	Yes (MoU)	Australia	Yes (MoU)
Armenia	Yes (DoE)	Poland	Yes (L)	Austria	Yes (L)
Georgia	Yes (MoU)	Russia	Yes (L)	Czech Republic	No
Kazakhstan	Yes (PD)	Serbia	Yes (MoU)	Denmark	Yes (MoU)
Kyrgyz Republic	Yes (MoU)	Ukraine	Yes (DoE)	Hungary	No
Kosovo	Yes (MoU)			Norway	No
Macedonia	Yes (MoU)			Sweden	Yes (MoU)
Montenegro	Yes (L)			UK	No

L=Law, DoE=Decision of the Executive, PD=Presidential Decision, MoU=Memorandum of Understanding.

All ECA countries have a CFSC, mostly set outside of the CB with MoUs. In the benchmarking countries where the CB is responsible for the MBS, CFSC structures are not used. And when the CB has no or limited MBS responsibilities, the CFSCs are set outside the CBs by a MoU.

**TABLE 7: INSTITUTIONAL STRUCTURE FOR THE COORDINATING FINANCIAL STABILITY COMMITTEE**

Coordinating Financial Stability Committee	CB is responsible for MBS	CB is partially responsible for MBS	CB has no direct MBS responsibilities
Yes, at the CB	Yes (DoE)		
Yes, outside of the CB 1/	Albania, Georgia, Kazakhstan 2/, Kyrgyz Republic, Moldova, Montenegro 2/, Serbia 2/, Poland 3/, Russia 3/, Ukraine	Austria	Denmark 3/, Sweden 3/, Australia 2/3/
No	Czech Republic, Hungary, the UK		Norway

1/In many cases, the committee does not have a legal personality.

2/Countries where the coordinating FSC is chaired by the governor of the CB are marked with "2/". In Hungary, Poland and Ukraine, the chairmanship rotates between MoF and the CB. In Albania, Moldova, Austria, and Sweden, the MoF is the chairman. In Denmark, the Ministry of Economic and Business chairs the Committee. In Kyrgyz Republic, the chairman is the Prime Minister; and in Russia, the role belongs to the First Deputy Prime Minister. In Georgia and Kosovo, there is no chairmanship. In Norway, the collaboration was formalized by the introduction of regular meetings (at least twice a year) attended by the three institutions involved and chaired by the MoF.

3/Countries where the secretariat functions of the coordinating FSC are NOT handled by the Central Bank are marked with "3/". In Poland, the MoF assumes a secretariat role during the times of the crisis. In Denmark, Ministry of Economic and Business Affairs; and in Australia, the Australian Prudential Regulation Authority (APRA), have the secretariat role. In Russia, Central Bank, MoF, the First Deputy Prime Minister's Office, Ministry of Economic Development oversee the secretariat function. In Sweden, the Committee has its own secretariat. In Kosovo, secretariat role is not defined.

The CB generally provides the secretariat function for CFSC in ECA, but it chairs the committee only in some cases. In the benchmarking countries, when CFSC structure is used, the MoF/another part of government usually chairs the committee and provides secretariat functions.

### 6.1.2. Powers and Decision-making Structures for CFSCs

It is not necessary for the CFSC to have its own formal powers for decision-making. In a group setting with different authorities, reaching a policy decision may take longer. This could be an issue if timely decisions need to be made under changing circumstances. A committee structure may also expose policymakers to politics as well as the financial industry's influence as some participating authorities may not have budgetary and/or political independence. If the accountability framework is not properly set up, decision-making through a committee structure may also incentive forbearance, and facilitate “blame-shifting”, especially when multiple agencies are involved. Keeping a CFSC mandate (in the legal base) as a consultative body may help preserve independence and accountability of member authorities.

If the CFSC has its own formal powers, the voting arrangements would be crucial for its effectiveness. In principle, the CFSC should aim to work by consensus. However, disagreements could emerge, persist, and delay policy action. Voting should be subject to a simple majority or a qualified majority rule, rather than an unanimity rule. This will prevent a single committee member from blocking a policy decision and ensure action is taken even in case of persistent disagreement between member agencies.<sup>32</sup> However, to protect the integrity of the autonomy of authorities, some safeguards are needed. For example, recommendations should be of a general, rather than overly specific, nature, they not conflict with other authorities' objectives, and should be confined to areas where a receiver of the “recommendations” already has legal powers to take an action.

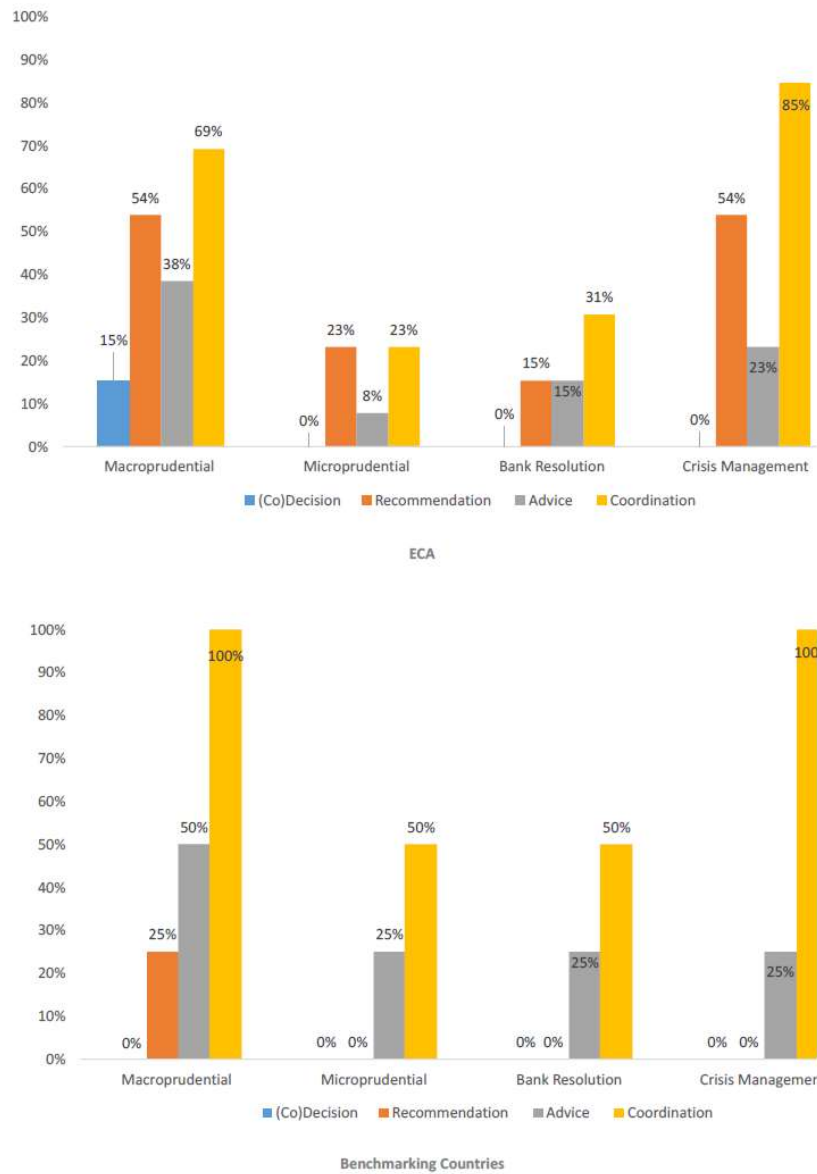
The powers of the CFSCs and modality of decision-making also vary between ECA and the benchmarking countries (Figure 10). In ECA, it is relatively common for the CFSCs to have recommendation or advice powers, mostly for MaP and crisis management. The main decision-making procedure at the CFSCs is a majority vote. Together with the strong political representation at the CFSCs, this may raise independence concerns in ECA. In the benchmarking countries, the CFSCs have only advice powers<sup>33</sup>; while the coordinating responsibility is always explicitly acknowledged for MaP and crisis management functions. Generally, no voting takes place in line with limited designated powers of the committee (only advice and/or coordination).

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<sup>32</sup> Depending on the significance of the matter to decide, the CFSC could have a choice to use either a simple majority rule or a qualified majority rule—for example, a qualified rule could be used for making a recommendation in times of crisis or making a recommendation.

<sup>33</sup> Except for MaP in a few cases.

**FIGURE 10: POWERS OF THE CFSCS IN ECA AND BENCHMARKING COUNTRIES**



The CFSCs often have recommendation (with comply or explain) or advice powers in ECA. In the benchmarking countries, the CFSCs are used as a coordination platform.

## 6.2 Other Formal and Informal Arrangements for Coordination among MaP, MBS, and BR

Other formal and informal arrangements can help ensure efficient coordination and cooperation among MaP, MBS, and BR policies. At a minimum, financial policy governance should facilitate data and information sharing among authorities and their staff as well as close interaction and collaboration during the decision-making process. As tensions can arise, review and conflict resolution mechanisms need to be spelled out in advance. There also need to be mechanisms in

place to test and validate the crisis preparedness processes and procedures and ensure timely and efficient decision-making in a crisis.

### **6.2.1. Data-Sharing and Information Exchange**

The exchange of data and information will improve analysis and help develop a common perspective and coherent policy approach among the authorities (or departments within the same authorities) and their staff. Legal obligations—which may take a variety of forms from Exchange of Letters to MoU and legislation—can be used to formalize information sharing and coordination of actions. Among others, a clear legal basis should define who can (directly) access which data. While objectives and mandates may differ, analysts and decision-makers in the relevant agencies should ideally have access to all pertinent available data. Data-sharing may still happen in the absence of an explicit legal framework, but this can lead to asymmetrical information (with potentially disastrous outcomes in times of crisis), and ad-hoc treatment of authorities/users.<sup>34</sup>

In ECA, executive decisions, at times in combination with exchange of letters, provide the legal base for cooperation and information sharing, usually in the context of CFSCs (Figure 11). Still, cooperation frameworks among MaP, MBS and BR policies are not formally defined in about 40 percent of the ECA cases. In the benchmarking countries, legislation is more commonly used to formalize the framework for information exchange and coordination of actions. Whether these policies are handled by separate authorities or a single authority affects the legal basis for cooperation and information exchange. When separate authorities are responsible for different policies, countries have developed more formal coordination and information-sharing arrangements (enshrined in the law), particularly for the BR policy in ECA (100 percent compared to 40 percent). This is in sharp contrast with the benchmarking countries where these arrangements are in the law regardless of the institutional model.

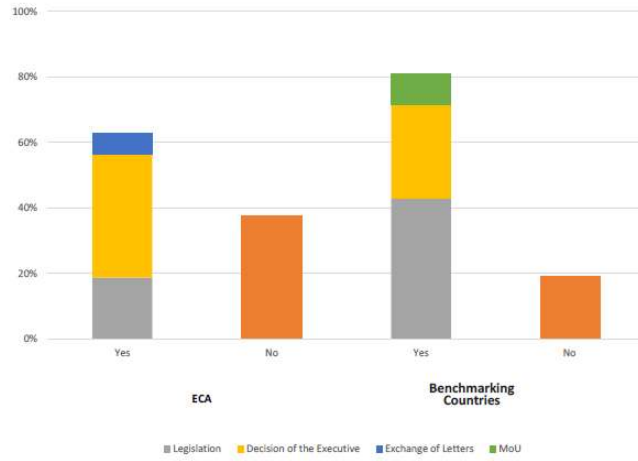
Even if it exists, the formal framework for cooperation in many ECA and the benchmarking cases usually does not detail who can (directly) access which data (Figure 12). The legal base for the MaP policy to access data is particularly weak. For example, in about 90% (80%) of the cases, the legal base is silent about the access to data between MaP and MBS (MaP and BR) policies in ECA. Both MBS and BR policies are allowed to access each other's data through some legal arrangement in ECA in more than half of the cases; while in the benchmarking countries, the legal framework often permits one-way data flow from the MBS to the BR. This generally hold true regardless of the institutional model.

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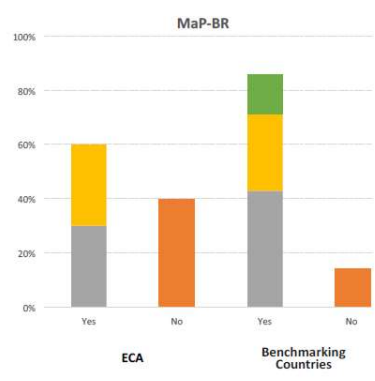
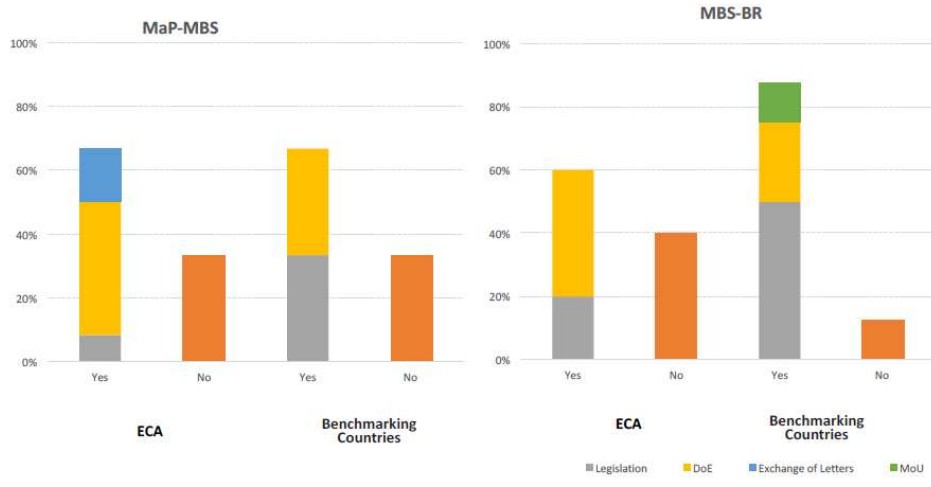
<sup>34</sup> See BIS (2015).

**FIGURE 11: THE LEGAL BASE FOR COOPERATION/INFORMATION-SHARING**

**PART A. OVERVIEW**

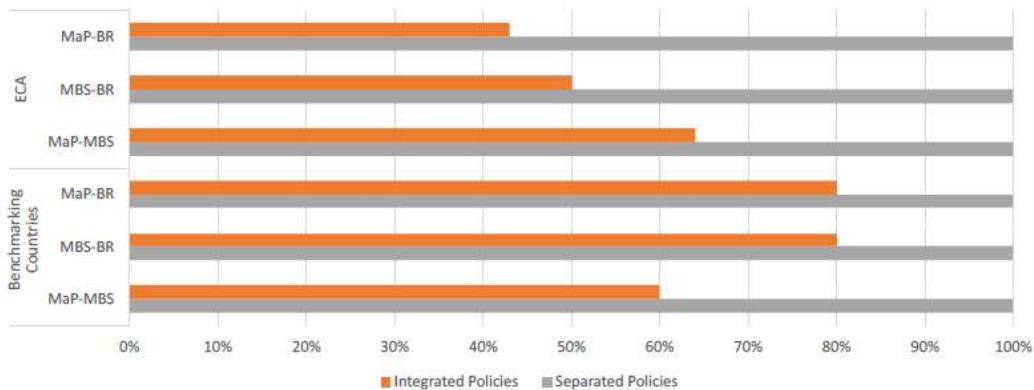


**PART B. MAP—MBS, MBS—BR, AND MAP—BR**



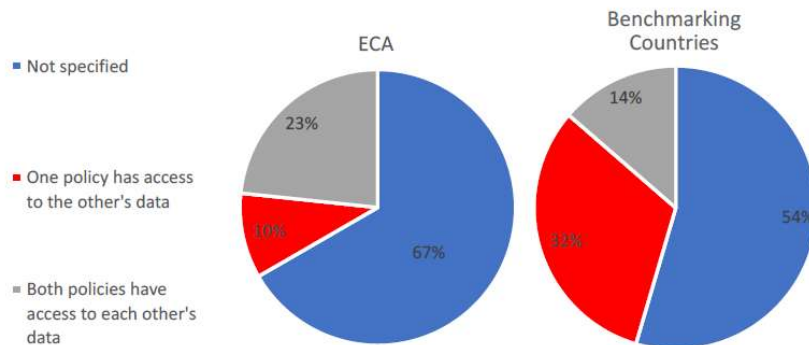


PART C. INTEGRATED VS. SEPARATED POLICIES: PRESENCE OF A LEGAL BASE FOR INFORMATION-SHARING



In ECA, cooperation frameworks among MaP, MBS and BR policies are often not formally defined, especially if they are under a single roof. In the benchmarking countries, legislation is more commonly used to formalize the framework for information exchange and coordination of actions, regardless of the institutional model.

**FIGURE 12: ACCESS TO DATA AMONG POLICY FUNCTIONS**



The formal framework for cooperation, when it exists, often does not detail who can (directly) access which data in many ECA and the benchmarking cases.

Despite the broad-based lack of legal base for cooperation and information sharing, countries do share information on a regular basis or as needed (Table 8). In ECA, the policy functions regularly exchange information, typically including institution-specific information, in about 60 percent of the cases. As mentioned before, inter-agency information sharing happens through the CFSC meetings in ECA. However, MoUs or DoEs—that commonly provide the formal arrangements for these meetings—neither usually define information sharing as duty (Figure 13)<sup>35</sup> nor give to the authorities the power to share the data. When policy functions are part of a single authority, internal arrangements set out the expectations of the management/staff for

<sup>35</sup> This would in principle help avoid situations where a department/authority denies a data request of another department/authority. It also encourages departments/authorities to be proactive in considering what information they need to share.

appropriate sharing of information. More broadly, one major advantage of having the financial policy functions under one roof in ECA seems to be the improved access to related information, especially between MBS and BR functions. In the benchmarking countries, information sharing happens more ad-hoc. Nevertheless, when policy functions are handled by separate authorities, information sharing is defined more formally as a duty.

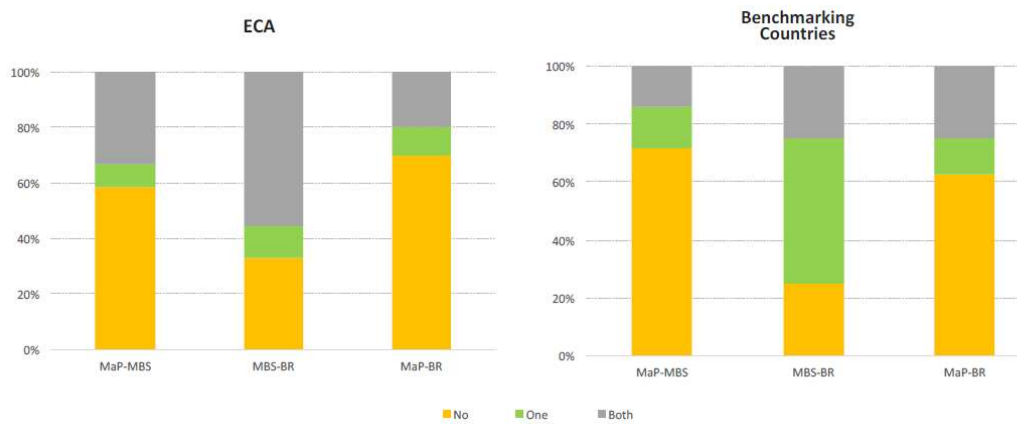
**TABLE 8: INFORMATION-SHARING PRACTICES AND DUTIES AMONG POLICY FUNCTIONS**

	Frequency of sharing information	Type of Information	Duty to share information
<b>ECA</b>	Monthly (12)	General, sectoral, institution-specific (23)	No (17)
	Quarterly (8)		Both policies (11)
	Ad-hoc (9)	General, individual (5) Other (2)	One policy (2)
	<b>Total</b>	<b>29</b>	<b>30</b>
<b>Benchmarking Countries</b>	Monthly (1)	General, sectoral, institution-specific (20)	No (12)
	Bi-annual (2)		Both policies (4)
	Ad-hoc (19)	General, sectoral (1) Other (1)	One policy (6)
	<b>Total</b>	<b>22</b>	<b>22</b>

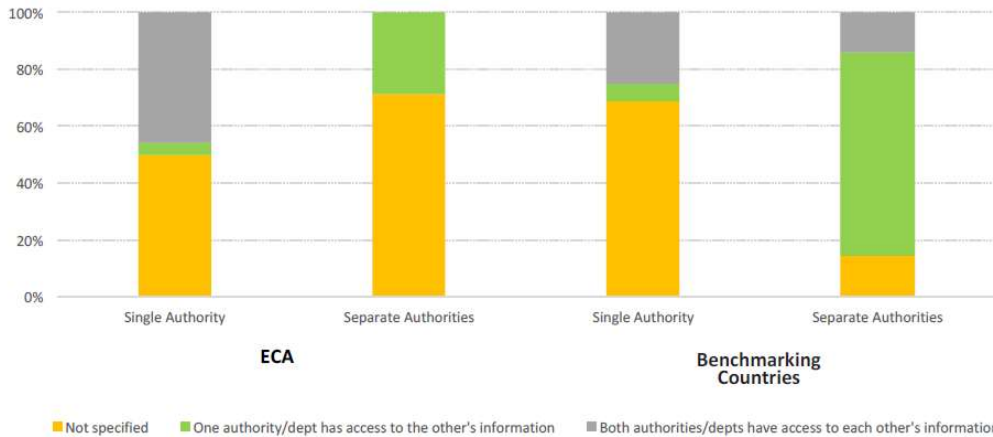
In ECA, policy functions often regularly exchange information, typically including institution-specific information. In the benchmarking countries, information sharing happens on a more ad-hoc basis.

**FIGURE 13: DUTY TO PROVIDE INFORMATION TO OTHER POLICY FUNCTIONS**

**PART A. MAP—MBS, MBS—BR, AND MAP—BR**



## PART B. INTEGRATED VS. SEPARATED POLICY FUNCTIONS

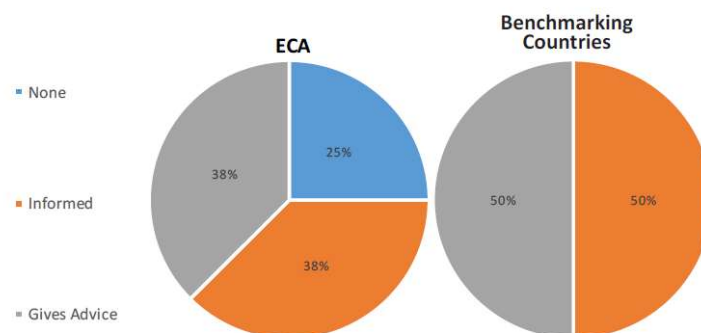


Providing relevant information to the related authorities/departments is often not defined as a duty in ECA, particularly policy functions are integrated in a single authority. It is more common to have such arrangements between MBS and BR policy functions both in the ECA and in the other countries.

There needs to be an enhanced interaction between MBS and BR functions in some resolution steps. For example, the MBS department (or authority) should at least inform the BR department (or authority) in all instances when resolution triggers are breached. This is the case in ECA and in the benchmarking countries most of the time (Figure 14). However, in 25 percent of the ECA cases, the RA is not informed until after the fact.

The BR department (or authority) may also benefit from interaction with the MaP department (or authority). For example, the latter is always involved in the decision regarding the system-wide importance of the banks (Table 9). It is also consulted on the use or exclusion of bail-in in half of the cases.

**FIGURE 14: THE INVOLVEMENT OF THE BR DEPARTMENT/AUTHORITY IN THE BANK RECOVERY MEASURES (UNDER EARLY INTERVENTION)**



There are cases in ECA that the MBS department (or authority) does not inform the BR department (or authority) early intervention is started after the fact.

**TABLE 9: INVOLVEMENT OF MAP DEPARTMENT/AUTHORITY IN BR ISSUES**

	The decision on the system-wide importance of the banks		The use or exclusion of bail-in	
	Recommendation	Advice	Recommendation	Advice
ECA	38%	63%	13%	50%
Benchmarking Countries		75%		50%

MaP is always involved in the decision regarding the system-wide importance of the banks in ECA, and it is also consulted on the use or exclusion of bail-in in half of the cases.

### 6.2.2. Interaction Throughout the Decision-Making Process

The interactions at the working level for data and information sharing need to be complemented by some overarching arrangements to strengthen cooperation throughout the policy decision-making process. Interaction among senior policy-makers in the decision-making process effectively helps achieve consistency of policy views and manage the trade-offs between objectives in a timely manner. This can take several forms. An important example is cross-representation in decision-making bodies, when different policy mandates are assigned to different distinct authorities or decision-making bodies within the same authority. Early policy meetings (in advance of decision-making meetings) can also be useful as a crosschecking and information vehicle to discuss analysis and policy among senior/middle management level.<sup>36</sup>

Even if MaP, MBS and BR policies are integrated in a single authority, it is relatively common for both ECA and the benchmarking countries (50 percent of 40 percent, respectively) to have separate decision-making bodies (or persons) responsible of different policy functions within the same authority. There is cross-representation in the decision-making bodies in about 40 percent of these cases in ECA, while it is most common between MBS-BR functions (Figure 15). In the benchmarking countries, when the policies are integrated into a single authority, there is always cross-representation. In this respect, institutional structure seems to matter. When there are separate authorities responsible for MaP, MBS, and BR, a role in the decision-making of other policies remains low at around 20 percent across the country groups. In ECA, the authority responsible of MBS is always represented at the Board/Committee level decision-making meetings for MaP or BR, and the BR authority is also often involved in the MaP.

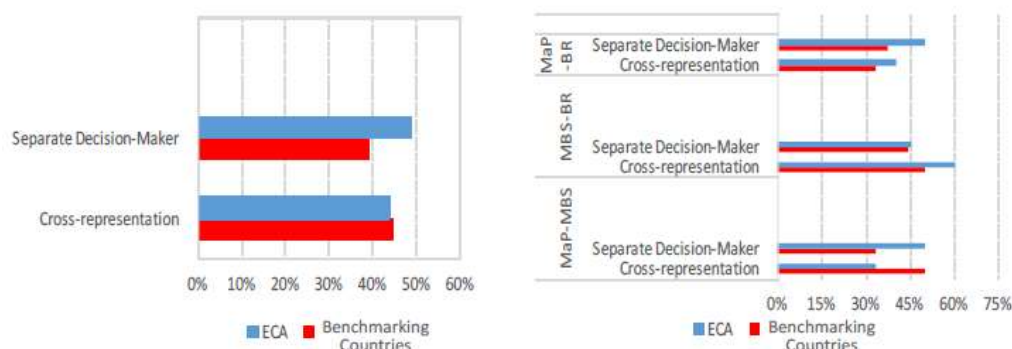
There could be other governance arrangements that help facilitate crosschecking and flow of information on analysis and policy before final decision-making. For example, early policy meetings among heads of key responsible departments and sometimes high-level management (the Board members/Directors) are held in about half of the ECA and benchmarking cases. The findings of these meetings sometimes serve as input to the meetings at the decision-making level, notably with a comply or explain clause in the

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<sup>36</sup> The findings of such meetings/panels could serve as an input to the meetings at the decision-making level.

benchmarking countries. In ECA, early policy meetings are most common between MaP and MBS policies when policies are handled by the CB. In the benchmarking countries, such interaction does not happen when there are separate authorities for separate policies.

**FIGURE 15: SEPARATE DECISION-MAKING AND CROSS-REPRESENTATION**



There is often cross-representation in the decision-making bodies among policies, especially between MBS-BR and when they are under a single roof. In the benchmarking countries, when the policies are integrated into a single

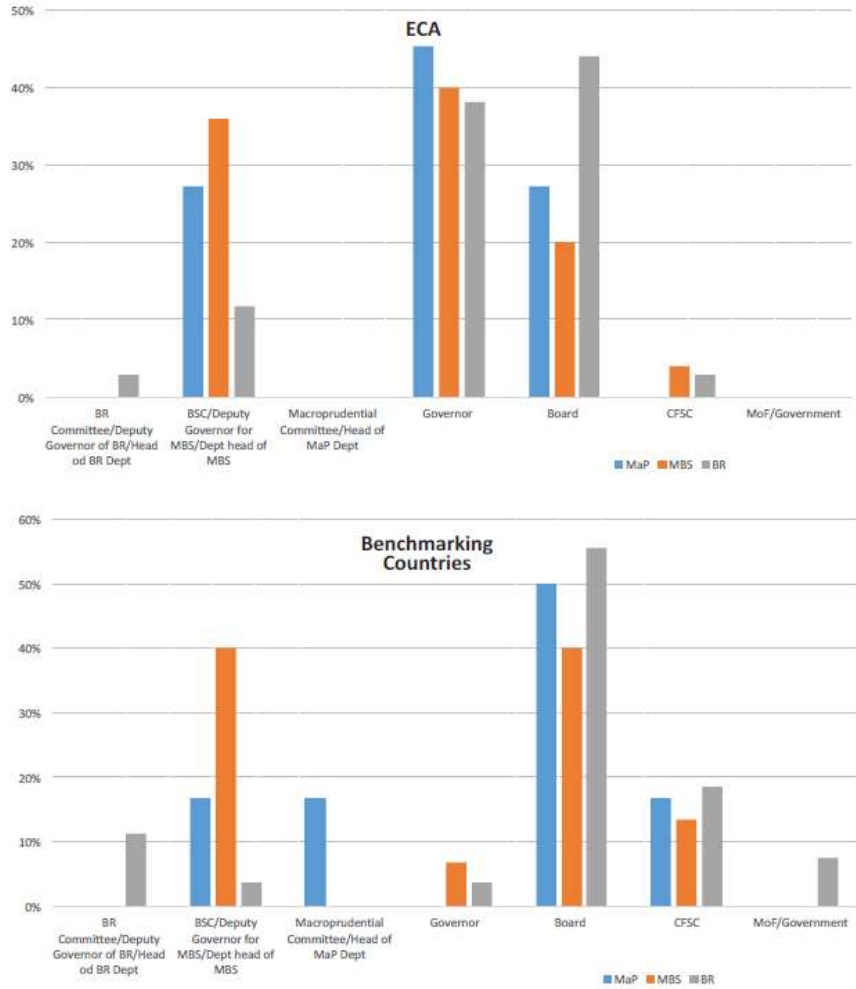
### 6.2.3. Review and Control Resolution Mechanisms

Tensions between the different policies may still arise, especially in “bad times”. Information sharing mechanisms among financial sector policy functions as well as the involvement of authorities in the decision-making process of other functions facilitates effective coordination and collaboration arrangements. However, this does not avoid conflicts at all times. Such conflicts can lead to counteracting measures, or lags in implementation of the appropriate policy. As such, it might be useful to define ex-ante review and conflict resolution mechanisms. For example, the legal base can specify who has the ultimate decision-power in the event of policy disagreements (when they are integrated in a single authority). Informal mechanisms can also be used to enhance interaction among policies so that conflicts are resolved efficiently and ideally in a constructive manner. For example, advisory or standing subcommittees and ad hoc working groups can serve as a platform to validate policy proposals.

While the definition of a hierarchy of policy functions is not appropriate when independent authorities are responsible for different policies, it might be useful when they are integrated in a single authority to swiftly resolve policy disagreements. In ECA, in about 40 percent of the integrated cases across all policy functions, the governor has the final say in the event of policy disagreements (Figure 16). It is also common among countries in the region that the Board has the ultimate decision powers, especially regarding MaP and BR. In about 30 and 35 percent of the cases, (internal) Banking Supervision Committee/Deputy Governor for MBS/Department head of MBS decides how the conflicts should be resolved for MaP and MBS functions respectively. In the benchmarking countries with integrated authorities, the Board has the final say in about half of the cases in MaP and BR

functions, and if disagreements on the MBS policy decisions arise, either Banking Supervision Committee/Deputy Governor for MBS/Department head of MBS or the Board decides on the outcome. The CFSC also play a role in resolving the conflicts in about 15% of the cases. Naturally, when the responsible authorities are separated, they each have the final say on their respective policy function in most of the cases in ECA and in all cases in the benchmarking countries.

**FIGURE 16: THE FINAL SAY IN THE EVENT OF POLICY DISAGREEMENTS**



In ECA, it is common to have the governor to have a final say in the event of policy disagreements. In the benchmarking countries with integrated authorities, the Board has the final say in about half of the cases in MaP and BR functions, and if disagreements on the MBS policy decisions arise, either Banking Supervision Committee/Deputy Governor for MBS/Department head of MBS or the Board decides on the outcome.

Countries also rely on other mechanisms to resolve the policy disagreements. In ECA and in the benchmarking countries, joint meetings that are attended by department/authority heads and sometimes directors/board members are often used when such situations arise. For MaP and MBS functions, CFSC/other advisory committees also serve as a platform to validate the policy proposals (especially when responsible authorities are separated, but

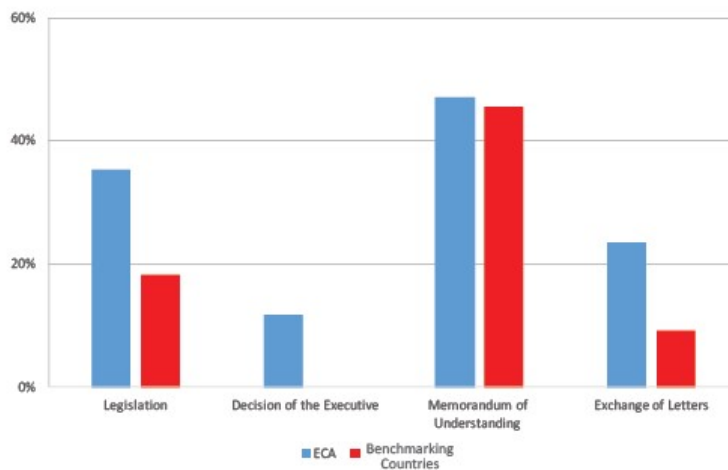
authorities generally cannot be forced into action if that would conflict with their mandate). In some cases where the policies are integrated, consensus decision-making at the Board level is aimed to achieve consistent decisions. In the other countries, there is a legal obligation to inform/consult the other authority(ies) prior to adopting some decisions.

### 6.3 Coordination in Crisis Times

There need to be mechanisms to provide assurance on the crisis preparedness process and ensure the crisis decision-making process is smooth and prompt. Preparing and dealing with a crisis is complex and can involve numerous financial safety net players and stakeholders. An appropriate legal framework can provide clarity on the respective roles of institutions involved and can facilitate close coordination among policy functions.

In ECA and in the benchmarking countries, the modes of cooperation and procedures for crisis preparedness and management among different authorities (or departments) are most commonly specified through an MoU (Figure 17). This does not change the instruments available to the authorities, but it does clarify responsibilities and enable authorities to practice in advance how they communicate during a crisis. In about 30%, legislation specifies the manners of information sharing, (including confidential information), decision-making, reporting and accountability requirements for the parties involved. There are, however, also cases (in both ECA and the benchmarking countries) crisis management is left to ad-hoc arrangements depending on circumstances.

**FIGURE 17: LEGAL BASE FOR COOPERATION AND PROCEDURES FOR CRISIS PREPAREDNESS/MANAGEMENT**

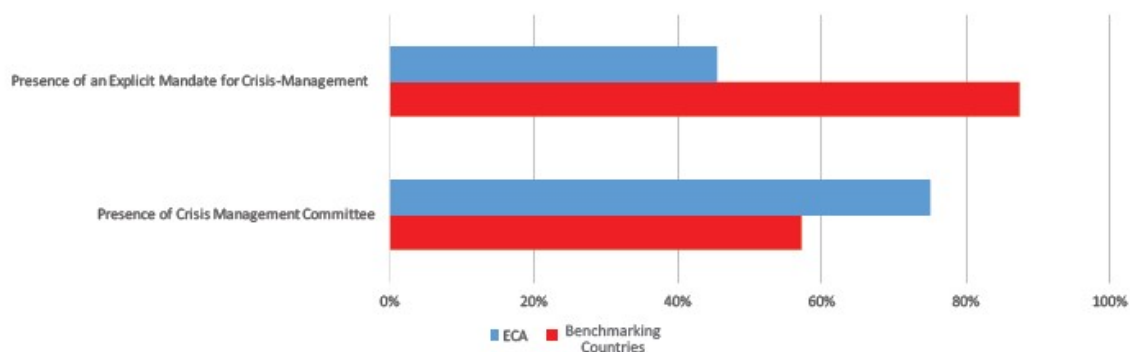


In ECA and in the benchmarking countries, the modes of cooperation and procedures for crisis preparedness and management among different authorities (or departments) are most commonly specified through an MoU.

In ECA, in about half of the cases, there is no single institution with an explicit mandate for crisis preparedness and management (Figure 18). Some have established a high-level crisis-management committee (CMCs) mainly for effective policy development and

coordination with the government. In the majority of the benchmarking countries, special institutional structures for crisis management are provided for in the legal framework. This often includes a dedicated CMC.

**FIGURE 18: LEGAL MANDATE FOR CRISIS MANAGEMENT AND CMCs**



In ECA, in about half of the cases, there is no single institution with an explicit mandate for crisis preparedness and management. In many of these cases CFSC assumes crisis responsibilities during the times of stress.

In ECA, MoF and the CB are often voting members of the CMCs (Figure 19). When there is a separate microprudential supervisor or RA, they also vote in the CMCs; while DIAs sometimes attend committee meetings as an observer or a non-voting member. MoF or other government authorities chair the committee in about 70 percent of the cases in the region. In the benchmarking countries where the MaP more commonly resides with the microprudential supervisor, the powers of the CB in the CMCs are more limited—they have voting rights only in 30 percent of the cases (which partly reflects CMCs having only an advisory role, so no voting takes place, in some countries); and chair the committee only about 20 percent of the cases.

A clear definition of the leader in the face of the crisis would support provide fast and efficient decision making and accountability by, at minimum, limiting power plays and blame-shifting. In ECA, in 30 percent of the cases, multiple authorities are identified as “lead” institutions (or “lead” in different parts of a crisis). In the rest of ECA cases, CFSC often takes the lead, followed by CB and MoF.<sup>37</sup> In the benchmarking countries, having multiple authorities or MoF in the lead is common. In 30 percent of all cases (ECA or otherwise), institutional arrangements for leading crisis management (particularly if multiple authorities are involved) are formalized in the context of an MoU. Powers to lead in crisis times for CBs (and MoFs in the benchmarking countries) are often legislated.

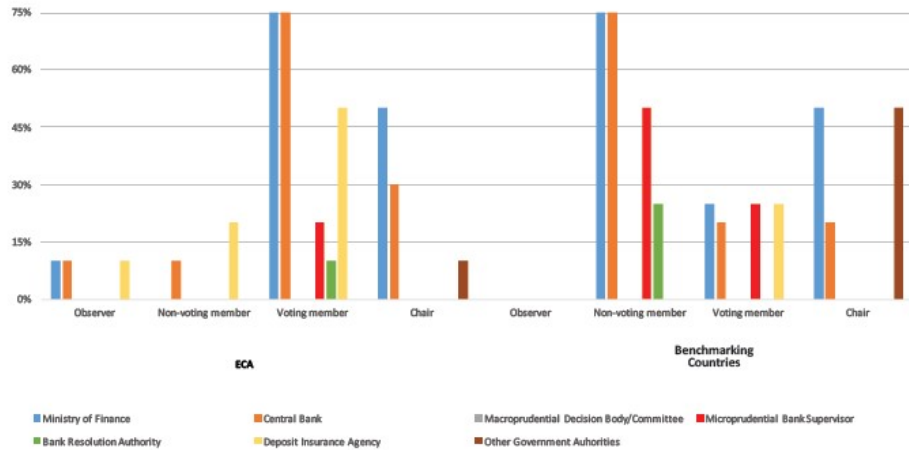
Regardless of who leads the crisis management efforts, an authority be given the responsibility to determine whether a distress situation requires triggering of crisis actions and powers and be accountable. This authority is the CB in many ECA cases. MoF

<sup>37</sup> CFSC assumes the crisis management role in ECA, except for Armenia, Georgia and Serbia.



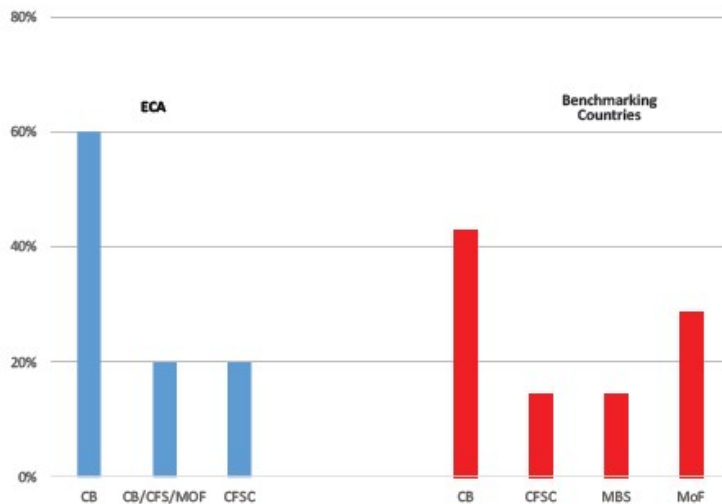
(sometimes jointly with the CB and the CFSC) or microprudential supervisor also have triggering powers in some of the benchmarking countries, in line with their more diverse institutional models (Figure 20).

**FIGURE 19: MEMBERS AND THE CHAIR OF CMCS**



In ECA, the MoF and the CB are often voting members of the CMC, and MoF or other government authorities commonly chair the committee. The member structure also reflects the fact that the CFSCs turn into CMCs during the times of stress in ECA, except for Armenia, Georgia and Serbia.

**FIGURE 20: TRIGGERING OF CRISIS ACTIONS AND POWERS**



In most of ECA, the CB is given the responsibility to determine whether a distress situation requires triggering of crisis actions and powers. MoF (sometimes jointly with the CB and the CFSC) or microprudential supervisor also have triggering powers in some of the benchmarking countries.

While the work to further strengthen bank crisis management and resolution frameworks is underway in ECA and in the benchmarking countries, several shortcomings remain. The lack of sound recovery and resolution plans and, more generally, strong resolution

frameworks still present the most important challenges during the times of stress for many ECA countries (and elsewhere). Obstacles related to the institutional setting for system-wide crisis management, such as the use of public funds/ liquidity support from the CB or the lack of clarity on who is in the lead in triggering crisis powers and using them, also remain. This in turn implies that, while countries are developing their resolution frameworks, they should also step up their efforts to strengthen the governance arrangements of a broader crisis management framework to achieve efficient outcomes.

## **7 General takeaways and policy recommendations for ECA**

Our survey findings indicate that there is a room for improvement in financial policy governance in ECA and that crisis management frameworks are in their infancy. In particular, there are several flaws in the institutional arrangements for (newly established) MaP and BR functions. Moreover, whether sufficient and effective coordination and collaboration among different functions can be achieved through the CFSCs remains unclear and in most cases untested. Data and information/ analysis sharing often do not have a legal base and usually depends on personal contacts. Conflict resolution mechanisms among different policy functions are yet to be defined.

Reflecting historical and legal issues and capacity constraints, CBs in the region are generally responsible for all financial sector related policies (MaP, MBS and BR functions). This, by itself, is not an impediment for a sound governance framework but it does not necessarily provide a mechanism for information/data flow, or more broadly for coordination and cooperation among policy functions either. The main benefits of integrating all three policy functions in the CB are easier access to information, skills and expertise, economies of scale and taking advantage of the CB's independence, which is usually firmly rooted in the law. Indeed, in those rare cases where the MaP or BR are outside of the CB, the members of the relevant committee or council frequently do not have a fixed or minimum service term, leaving them vulnerable to political and/or industry interference. Also, there is a risk that credibility and commitment is absent, and the relevant decisions have a short-term horizon.

### **7.1 Governance framework for MaP, MBS, and BR**

**Guiding principle 1.** *Sound governance for each policy requires clarity of mandate, ownership of implementation/enforcement, and accountability and integrity.*

The articulation of a clear and explicit mandate for MaP and, to a lesser extent BR, is missing in many ECA countries, yet this hasn't stopped the relevant authorities from establishing MaP and BR governance structures, strategies and policies. All benchmarking countries have a solid legal basis for MaP and have established dedicated departments. ECA countries, on the other hand, have only established overarching MaP councils or committees, communicated policy strategy and policy decisions, and published regular financial stability reports without an explicit legal mandate or department. Surprisingly,

those ECA countries that have recently integrated an explicit MaP mandate in their central bank law, have yet to communicate policy strategy and decisions or publish financial stability reports.

Our findings also reveal ECA country accountability regimes across the three policy functions are significantly weaker than the benchmarking countries. Measuring regulatory performance, and hence imposing accountability, is challenging particularly for MaP and MBS where there are no quantitative targets like monetary policy. Even so, it is good practice to publish periodic written and oral reports to the executive or legislative branch of government. This is still relatively rare in ECA as opposed to the benchmarking countries where strong accountability requirements evidenced by frequent communication across all three policies are observed.

When the three policies are housed in the CB, the Board or the Governor make the final decisions. For MBS decisions, however, there are often expert advisory committees providing recommendations or advice to the Board or the Governor. In the rare cases in ECA where the Governor or Board are not the final decision makers, a supervision committee takes on that role. In the benchmarking countries, no advisory committees exist, the decisions are generally made directly by the supervision committee, Board or Governor.

Most surveyed ECA countries have opted to house the BR decision-making body within the CB. Hence, the CB executive Board generally decides on resolution, sometimes advised by a CFSC. Where a separate resolution authority exists, it will also assume the role of a deposit insurer and take advice from CB and/or CFSC. In the benchmarking countries, the CB delegates more frequently to separate resolution committees, even though their members are usually also not subject to fixed term appointments. MOF's role is more significant than in ECA, through advice or recommendation. Where the RA is housed within the micro prudential supervisor, the CB gives advice through the CFSC or directly.

The role of the government in ECA is generally less important than in the benchmarking countries, particularly for MaP, reflecting the relative high weight of Scandinavian countries in the benchmarking group. In general, advice or recommendation powers are more common in ECA than in the benchmarking countries. The government has a direct or indirect (through the CFSC) MaP advisory role, but leads MaP very rarely. In the Scandinavian (benchmarking) countries, the government takes on a strong MaP role; it leads in all the cases. The influence of other authorities and the CFSC on MBS takes the form of "comply or explain" recommendations in about half of ECA, while it is generally advice only in the benchmarking countries. For resolution, various models exist but the MoF will always decide if public money is involved in ECA as well as benchmarking countries.

Operational and functional independence across the three policies remains relatively weak in ECA as evidenced by poor structural separation across the functions. Separation in

terms of reporting lines, financing lines and staff remains to be reinforced, particularly between MBS and MaP and BR and MaP. In the benchmarking countries, separation among the three policies has been ensured. Certainly, separation between policies needs to be accompanied by sound cooperation and coordination among them.

## **7.2 Coordination and collaboration among MaP, MBS, BR**

**Guiding principle 2.** *Strong collaboration and coordination among policies requires information sharing among mutually interested parties, interaction in the decision-making process, and efficient resolution of disagreements.*

Cooperation and coordination can take various forms ranging from the establishment of an CFSC to the introduction of a legal requirement for information sharing. When a CFSC is established, it is not necessary to grant specific powers, it can be a simple forum for information exchange and coordination. In case the CFSC has powers, however, it should always aim to reach consensus when using them. However, simple majority or qualified majority voting arrangements, ex ante conflict resolution mechanisms and clear safeguards to protect the integrity and autonomy of the relevant authorities will need to be established to prepare for instances where no consensus can be reached.

All ECA countries have opted for MOUs to create an CFSC which is chaired by the MOF or another part of government. This set-up reconciles the dominant role of CB in the region with the role of the government in times of crisis. The ECA CFSCs commonly have recommendation and advice powers, mostly for MaP and crisis management and they decide by majority vote. Given the stronger representation of the government on the CFSCs in the ECA region, there is the risk that this affects independence. The situation is very different in the benchmarking countries, where CFSCs are inexistent when the CB oversees MBS. Also, the CFSC's powers are generally limited to purely advisory.

A legal basis and sufficiently detailed arrangements for regular data sharing and information exchange at the technical level are crucial to develop a common perspective and policy response among authorities. Without common information, asymmetries can arise which will impede swift and consistent decision-making in crisis times. ECA countries generally use their CFSC's as inter-agency information sharing platforms and the legal basis takes the form of executive decisions and exchange of letters. Benchmarking countries turn more frequently to legislation to organize information exchange, probably reflecting the involvement of more players in their financial policies. Even where a legal base for information sharing is present through MoUs, the exchange of letters or an explicit legal reference, it is often formulated in too general terms, it lacks detail on who can access what, and is not always fully observed by authorities in both ECA and benchmarking countries.

Despite this lack of detail in the arrangements, information sharing does regularly take place in ECA countries, particularly between MBS and BR. That said, there is still room

for improvement as the MBS does not yet always immediately inform the BR when recovery triggers are breached. Also, information sharing between MaP and BR has yet to mature.

The data and information sharing at the technical level needs to be complemented by overarching arrangements to strengthen consistent decision making across all three policies. Even where all three policies are housed in the CB, they frequently use separate decision-making bodies for each policy. To ensure consistent decisions, cross representation is used in about half of the cases in both ECA and benchmarking countries. Cross representation is more common between MBS and BR and within a single authority. Other mechanisms to ensure coherent decision-making among policy functions, such as early policy meetings are also used in ECA. The latter are standard when the policies are integrated in the CB, but do not occur when separate authorities are responsible.

Information sharing and arrangements to strengthen consistent decision-making can reduce but not prevent tensions between different policies. Their handling will depend on the institutional arrangements; in case of separate authorities, each of them will have a final say in their relevant area, as an authority cannot be forced into an action that conflicts with its mandate. For integrated authorities, clear internal protocols and processes should be established. When conflicts arise within the CB in ECA, it is generally the Governor or the Board who has the final say. In other countries, consultation requirements among authorities exist or sometimes the CFSC is used as a platform to validate the policy proposals across authorities.

### **7.3 Crisis Management Framework**

**Guiding principle 3.** *An effective crisis management framework requires institutional arrangements that allow information sharing and decision-making in times of crisis to work fast and efficiently. Such arrangements need to ensure clarity of responsibilities in crisis and ultimate coherence of policy action*

Information sharing, decision making, reporting and accountability requirements among departments and authorities in crisis times are mostly laid out in MoUs or legislation in both in ECA and benchmarking countries. In some instances, however, no ex ante arrangements have been defined and the crisis will still have to be managed ad hoc. In half of the cases in ECA, there is even no explicit mandate defining who oversees crisis preparedness and management as opposed to the benchmarking countries where in much of cases this responsibility has been clearly assigned, very often in legislation.

The prominent position of CBs in ECA is mirrored in the presence of voting powers in the crisis management committees (CMC) for the CB and MOF. Also, the MOF or another part of government chairs the CMC in ECA in most of the cases. In the benchmarking countries, the role of the CMC is more often only advisory. The CBs is less influential generally because the powers and regulatory perimeter of the CB are more limited.

While the work to further strengthen bank crisis management and resolution frameworks is underway in ECA and in the benchmarking countries, several important shortcomings remain. The lack of sound recovery and resolution plans and, more generally, strong resolution frameworks present the most important challenges during the times of stress for many ECA and benchmarking countries. Obstacles related to the institutional setting for system-wide crisis management, such as the use of public funds/liquidity support from the CB or the lack of clarity on who is in the lead in triggering crisis powers and using them, remain. This in turn implies that, while countries are developing their resolution frameworks, they should also step up their efforts to strengthen the governance arrangements of a broader crisis management framework to achieve efficient outcomes.

## **8 Conclusions**

There are various forms of institutional arrangements for the conduct of MaP, MBS and BR but little consideration has been given to the interactions between them. This paper takes a novel view that arrangements that organize the interaction among different policy functions are critical elements of a sound overarching financial policy governance.

The role of the institutional structure is to support supervisors and regulators in effectively discharging their duties. There is no “one size fits all” and empirical evidence confirms that there is no superior arrangement. What remains crucial for supervisors and regulators is not the financial architecture but clarity of objectives and mandate, a high degree of operational and financial independence, transparency and accountability, adequate supervisory resources and effective enforcement powers. Yet, consideration needs to be given to the complex interactions between the three policy functions, to ensure that the objectives and tools used to promote one policy do not compromise the others.

Building on the findings from a comprehensive survey ECA countries and (high-income) benchmarking countries, we disentangle means and ways of sharing information and analysis, communicating all through the decision-making processes, and resolving conflicts when they arise, both in normal and crisis times. While there has been a lot of effort in the region to develop sound financial sector policy frameworks after the GFC, there is an ample room for further progress. In this respect, the findings of the survey point toward the need to adopt a clear legal framework and strengthened practices that ensure sound governance framework for each policy, strong coordination and collaboration among policies, and effective crisis management frameworks.

We present common practices and policy recommendations on the governance of financial sector policies in the post-crisis era for ECA, focusing on the coordination and collaboration among different policies. Regardless of the number of agencies, coordination arrangements should be formalized in a way that offsets the natural tendency of agencies to be territorial, avoid that information flows among policies on matters which interest all parties are sub-optimal.

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